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ECONOMIC

ECONOMICS OF JAPAN-U.S. TRADE FRICTION DISCUSSED

Tokyo KIKAN GENDAI KEIZAI in Japanese Spring 83 pp 30-47

[Article by Sueo Sekiguchi and Yasutoyo Shoda: "Economics of Japan-U.S. Friction"]

[Text] I. Introductory Remarks

Definition of Economic Friction

The title refers only to "friction" in order to avoid overlapping words, but the main topic of this article is the economic friction between Japan and the United States. When we refer to "friction" in economics, as, for instance, in the term "frictional unemployment," we generally mean a temporary disequilibrium generated in the process of reaching a long-term equilibrium. It is not necessarily a rare phenomenon for an inefficient enterprise to be closed down by competition between enterprises, or for workers to become temporarily unemployed until they are transferred to other employment.

A similar kind of phenomenon happens also in the process of international competition generated through international trade or investment. It is a normal phenomenon that an industry which is comparatively inferior in one country declines in that country while a corresponding industry with a superior position in another country expands. In each case it is beneficial for the country concerned to distribute resources to efficient industries.

However, as it has been frequently used in recent years the definition of the term, "international economic friction," in many cases has not been clear. Yet, it has a different meaning from the aforementioned "friction." We define economic friction between two nations as (a) dissension which occurs when a rival perceives that a certain country's domestic or international transactions constitute unfair competition and that government management policy is involved and that country rejects this idea, or (b) dissension which occurs when a country judges that its condition is such that it is difficult to manage its economy without restrictions and as an emergency measure requests that the opponent government make exemptions from application of general rules, but the opponent government refuses.

Let us elaborate a little further on this definition. We deem government involvement of each sovereign nation a necessary condition for "friction." In other words, even if a certain individual or enterprise causes a frictional phenomenon in the opponent country, we do not regard that as "friction between two nations" unless it becomes a subject of negotiation between the nations. (See Note 1)

Note 1. For instance, the industrial espionage case between IBM and Hitachi, and Mitsubishi is a problem between enterprises and between the U.S. judiciary and Japanese enterprises, and it cannot be considered an economic friction between Japan and the United States.

Needless to say, among phenomena generally called economic friction are included conflicts between private enterprises, between private parties and between industrial groups. In the event that such conflicts cannot be handled by the local laws of the country nations concerned, they develop into subjects for negotiation between governments. These constitute "latent" economic friction, yet they cannot be resolved through government policy. For that reason in this article we do not consider them as economic friction between two nations.

Scope of Discussion

One of the reasons why we use such a restrictive definition is that so-called economic friction is pointed out by businessmen's conferences or labor union representatives, and widely reported by newspapers, television and word of mouth. But many such discussions have no particular meaning. Also, unless the government has clearcut legal ground for regulating the behavior of private enterprises and private parties, the government cannot resolve friction. Of course, government policies often cause friction, directly or indirectly. Such cases become topics for negotiation between two governments.

In this article we will examine "economic friction between two nations" as defined above in the context of Japan and the United States. Economic friction between Japan and the United States can be generally described as follows:

First, there is friction over macroeconomic policy, including exchange policy. Some time back, in about 1977, based on the theory of Japan-U.S.-German "engines," the U.S. Government asked the Japanese Government to provide incentives to create domestic demand, and the Japanese side rejected this. Also, even though in early 1983 the "Presidential Economic Report" finally absolved Japan of its responsibility, in the 1981-1982 period, the U.S. side had denounced the low yen, causing a controversy to develop between the two nations. Friction in this area will be treated in Section II.

Second, there is friction in commodity trading by sectors. In this area, there are voluntary export restraints (import restrictions by the United

States) on iron and steel products, color television sets and passenger cars, among Japanese exports to the United States. On the other hand, the Japanese side restricts imports of agricultural products. Also, since the second oil crisis the petrochemical industry has been in a critical condition, and new friction has been generated in the field of intermediate products of the petrochemical industry. These problems will be examined in Section III.

Third, we will concern ourselves with friction derived from restraints against the activity of enterprises in each country as caused by increased direct investment, or derived from differences in domestic industrial policy, and individual controversies in the field called service trade. In concrete terms, we will concern ourselves with friction based on market control of finance and the securities business, controversies over the manner of government involvement in the distribution industries, and friction over Japan-U.S. aviation negotiations.

From the standpoint of quality, there are many problems concerned with how the two governments handle participation of foreign enterprises in their domestic market, and whether or not they adopt a policy of granting national treatment based on the principle of reciprocity. Needless to say, the problems are diverse, and they include fishery negotiations on the jurisdiction over natural resources and so-called "unfair competition" generated by differences in policy with regard to the "nurturing of formative industries." However, because of space limitations, it is impossible to examine all the problems. We still refer only to the most important points of argument.

Last, we will examine noneconomic factors, and summarize policy implications.

II. Macroeconomic Policy Controversies

Here, macroeconomic policy refers to the exchange rate policy and the comprehensive demand control policy. Beginning in the 1970's friction between Japan and the United States over macroeconomic policy has been generated mainly along the following three lines.

First, it reached a peak with the suspension of the dollar-gold exchange in the summer of 1971, and there was friction over the change in par value, popularly called the "Nixon shock."

Second, Japan being one of the "engine countries," in 1977, the Carter administration in the United States asked the Fukuda administration in Japan to adopt a policy geared toward expanding domestic demand and the Japanese side made such a noncommittal response that is hard to tell whether the Japanese rejected the request or tried to respond to it.

Third, we are concerned with U.S. criticism of the policy inducing a low yen which developed in the 1981-1982 period, and the Japanese criticism of U.S. financial and monetary policy--the criticism of the "high interest" policy.

Especially since 1979, defense policy has had a strong impact on macro-economic policy. For this reason the controversy over the division of responsibilities among allies has cast its shadow over macroeconomic policy. However, in this article we will treat it from an economic viewpoint.

Since the first aspect is a special case which occurred at the time of transition from the adjustable pegging system to the float system, it will not be treated in the following due to limited space. We will limit our discussions to friction over the exchange rates under the float system and the policy of controlling domestic demand, that is, the second and third aspects. (See Note 2)

Note 2. For friction prior to the multiple changes in par value in 1971 and appropriate ways of response, see the Exchange Study Policy Study Association.¹

First, let us look back at the friction between Japan and the United States started by the "theory of engine countries." As the oil crisis was added to the worldwide recession of 1972-1973, many countries fell into stagflation. In 1974 and 1975, all nations other than those belonging to OPEC were in economic recession, and escape from the recession became the policy task of the major nations in 1976. Moreover, with the exception of Japan, the United States and West Germany, the majority of the industrial nations had continuing inflation at home and the majority of developing nations suffered from deficits in international balance of payments. (See Note 3)

Note 3. For an analysis of the factors in inflation in Japan in 1973 and 1974, see Ryutaro Komiya,² and for the spread of inflation and recession in the Pacific rim, see Krause and Sekiguchi.³

The more than fourfold hike in petroleum prices brought about the transfer of huge sums of revenue from petroleum importing countries to petroleum exporting countries. This meant that unless the surplus from the balance of current accounts of exporting countries was recycled, demand would be suddenly and drastically reduced worldwide.

In early November 1976, a tripartite economists' conference was held. This was a conference attended by private economists from the three regions, Japan, North America and Europe. One of the writers also attended and helped formulate a draft. The main points in the policy proposals were as follows: (1) Since Japan, the United States and West Germany had brought domestic inflation under control and had surpluses in power supply, it was desirable for them to provide incentives to create domestic demand also as a domestic policy. (2) It was a desire of the entire world that demand spread to other economies as a result of such action. Thereafter this idea was taken up by OECD and the Japan-U.S.-Europe Commission, and was termed the "theory of engine countries." (See Note 4)

Note 4. The "theory of engine countries" was criticized for dictating policy and the responsibilities and rights of each sovereign nation. (See Ryutaro Komiya and Miyako Suda.⁴) However, the original intention was that since adjusting the exchange rate had only limited effects on the oil crisis, each nation should be encouraged to adopt a policy also suitable to its own country. Also there were some arguments for a favorable division of deficits from the balance of the current account, but because of opposition they were not brought to the foreground. For the original source, see the "Tripartite Report."⁵

The policy brains of the new administration in the United States accepted this argument for engine countries, but Japan and West Germany were ambiguous. In Japan, the Fukuda administration was inaugurated in December 1976. According to the government economic forecast in late 1976, as the real GNP would grow by 6.7 percent, there would be growth centering on domestic demand, and a \$700 million deficit in international balance of payments was predicted. (See Note 5)

Note 5. For the responses to the argument between governments and details at that time, see footnote 6.

It seemed to the U.S. Government that the Japanese Government had also basically accepted the "theory of engine countries" but in practice had decided not to carry it out--not a plausible analysis. Therefore, the U.S. Government interfered in the Japanese Government in favor of a policy controlling demand, which was like interfering in Japan's internal affairs. The Japanese Government's response to this was ambiguous, but among certain quarters in Japan strongly rejected it.

Let us examine facts according to economic data (Table 1). Although not shown in the table, in 1976 Japan's overall balance of payments was already considerably in the black, and its foreign currency reserve had been increased, too. Therefore, the U.S. side anticipated that the Japanese Government would intervene for the low yen. As a matter of fact, the factors for the supply of high powered money in Japan in 1976 reveal that the foreign exchange fund showed dollars being bought and yen being sold. The surplus buying of dollars persisted steadily from the first quarter to the fourth quarter of 1976. Although at that time capital transactions remained under various controls, ultimately this helped the central bank's prevention of a rise in the yen-dollar rate through purchasing dollars. When we examine the current account, which becomes the source of the demand for the yen-dollar flow, we see that it certainly went into the black beginning in the second quarter of 1976, its range was expanded and a trend toward a high yen appeared. Also, interest rates in Japan were higher than in the United States, and this was a factor in causing a high yen. On the other hand, when we use GNP deflators as indexes of change in purchasing power parity, we see that the inflation rate in Japan was higher, and that was a factor for a low yen.

Table 1. Major Japan and U.S. Macroeconomic Indexes

| | 実質GNP(日本) | | 米 | | GNPデフレーター | | (4) レートドル | (5) 米ドル | (6) 金利率 日(%) | (7) 金利率 日(%) | (8) インフレ率 GNPデフレーター |
|------|-----------|------------|-----------|------------|-----------|------------|--------------|------------|-----------------|-----------------|------------------------|
| | (9) 日本 | (10) 米国 | (9) 日本 | (10) 米国 | (9) 日本 | (10) 米国 | | | | | |
| 1976 | 1-3 | 6.4 | 6.7 | 2.03 | 7.7 | 5.9 | 302.39 | 109 | 2.581 | .99 | -6 |
| | 4-6 | 5.3 | 6.1 | 2.05 | 7.6 | 5.5 | 299.20 | 941 | 1.675 | 1.55 | .9 |
| | 7-9 | 5.4 | 4.4 | 1.99 | 7.7 | 4.9 | 291.06 | 983 | .60 | 1.29 | 2.4 |
| | 10-12 | 4.3 | 4.4 | 1.92 | 7.8 | 4.7 | 293.57 | 1,865 | 187 | 2.07 | 1.8 |
| 1977 | 1-3 | 5.4 | 4.4 | 1.97 | 7.5 | 5.1 | 285.57 | 893 | 2,639 | 1.26 | 1.6 |
| | 4-6 | 5.2 | 5.4 | 2.03 | 7.1 | 5.9 | 275.24 | 2,183 | 2,993 | .10 | -.2 |
| | 7-9 | 4.8 | 6.5 | 2.03 | 6.9 | 6.1 | 266.17 | 3,261 | 2,698 | .72 | -.7 |
| | 10-12 | 5.9 | 5.7 | 2.03 | 6.7 | 6.1 | 247.06 | 4,581 | 5,739 | 1.58 | -1.3 |
| 1978 | 1-3 | 5.0 | 4.4 | 2.20 | 6.3 | 6.1 | 237.64 | 3,971 | 5,957 | 2.30 | -1.0 |
| | 4-6 | 4.8 | 5.4 | 2.26 | 6.0 | 7.1 | 220.81 | 4,579 | 4,332 | 2.68 | -2.0 |
| | 7-9 | 5.3 | 4.5 | 2.28 | 6.0 | 7.8 | 192.84 | 5,146 | 33.50 | 2.84 | -3.1 |
| | 10-12 | 5.3 | 5.8 | 2.21 | 5.9 | 8.5 | 190.48 | 2,838 | 1,137 | 3.51 | -4.7 |
| 1979 | 1-3 | 4.7 | 5.2 | 2.10 | 5.9 | 9.3 | 201.46 | 711 | 823 | 3.53 | -5.6 |
| | 4-6 | 5.4 | 2.2 | 2.07 | 5.7 | 8.7 | 217.62 | 1,126 | 1,288 | 1.91 | -5.7 |
| | 7-9 | 5.4 | 2.6 | 2.11 | 5.9 | 8.6 | 218.86 | 3,229 | 744 | 1.79 | -6.4 |
| | 10-12 | 5.1 | 1.4 | 2.04 | 6.0 | 8.2 | 238.62 | 3,688 | 745 | 2.15 | -6.4 |
| 1980 | 1-3 | 5.4 | 1.5 | 1.92 | 6.3 | 8.6 | 243.54 | 5,810 | 1,800 | 2.32 | -7.7 |
| | 4-6 | 4.4 | 0.8 | 1.96 | 7.3 | 9.1 | 232.69 | 4,533 | 1,000 | .19 | -6.8 |
| | 7-9 | 4.7 | 1.5 | 2.04 | 7.7 | 9.4 | 220.08 | 1,011 | 3,380 | 1.03 | -5.8 |
| | 10-12 | 4.7 | 0.7 | 2.15 | 7.4 | 10.2 | 210.65 | 608 | 936 | 2.93 | -6.0 |
| 1981 | 1-3 | 4.0 | 0.9 | 2.19 | 7.4 | 10.3 | 205.57 | 2,076 | 3,245 | 4.67 | -5.8 |
| | 4-6 | 4.6 | 3.0 | 2.31 | 7.4 | 9.4 | 220.00 | 1,455 | 1,399 | 5.96 | -7.0 |
| | 7-9 | 4.1 | 3.2 | 2.16 | 7.4 | 9.3 | 231.89 | 3,531 | 731 | 7.21 | -7.5 |
| | 10-12 | 2.7 | 0.7 | 2.17 | 8.3 | 8.9 | 224.68 | 1,860 | 927 | 6.30 | 7.0 |
| 1982 | 1-3 | 2.1 | 2.5 | 2.25 | 8.8 | 7.2 | 233.49 | 912 | 1,075 | 7.07 | -5.0 |
| | 4-6 | 2.9 | 1.6 | 2.39 | 9.4 | 6.6 | 244.27 | 2,582 | 2,231 | 6.49 | -3.9 |
| | 7-9 | 2.7 | 1.9 | 2.37 | 10.0 | 5.6 | 258.86 | 2,924 | 4,227 | 5.19 | -3.3 |
| | 10-12 | NA | 1.2 | 2.42 | 10.7 | 4.6 | 259.68 | 2,302 | NA | 2.68 | NA |

Note: 1) Interbank monthly average. 2) Bank bond interest rate listed in Tokyo Stock Exchange for Japan. Bond distribution interest rate (5 years) for the United States. 3) Call rate for Japan, and federal fund rate for United States. 4) Real GNP growth rate and GNP deflator are comparison over the seasonally adjusted corresponding period of the previous year.

Source: "Nikkei NEEDS Data"

[Key on following page]

Key:

- | | |
|--|---|
| 1. Real GNP growth rate | 10. United States |
| 2. Unemployment rate | 11. Yen-dollar rate |
| 3. GNP deflator | 12. Japan (millions of dollars) |
| 4. Yen-dollar | 13. United States (millions of dollars) |
| 5. Balance of the current account | 14. Japan-United States (annual, % point) |
| 6. Long-term interest rate difference | |
| 7. Short-term interest rate difference | |
| 8. Inflation difference, GNP deflator | |
| 9. Japan | |

Beginning in 1977, inflation rates in Japan and the United States were reversed, and at the same time interest levels were also reversed. The United States went into the red in its overseas current account and moreover, its scale was increased. With Japan things were exactly reversed. The value of the yen compared with the dollar continued to rise, and it was turned around with the cooperative intervention in November 1978 and with the U.S. Government declaration for the defense of dollar value. From 1977 to the fall of 1978 the current account, the difference in the interest rate, and the difference in the inflation rate all served as factors for a high yen. And as a matter of fact, the exchange rate shifted accordingly.

As to the demand control policy in Japan, there was a confrontation at home between those advocating incentives to create domestic demand on the one hand, and those who advocated financial equilibrium and were against inflation on the other. However, rather than persuasively arguing for its choice, the Japanese Government responded with an excuse that it accepted the theory of engine countries but actually could not take actions consistent with it.

The yen being high from the end of 1978 caused Japan's balance of the current account to go into the red beginning in early 1979, and thus in effect adjusted the international balance of payments. After this came the Iranian revolution in 1979, the more than twofold hike of petroleum prices in the second oil crisis and the deficit in Japan's balance of current account further decreased. The difference in the interest rate between Japan and the United States dwindled for a while, but beginning in 1980 it began to expand due to the U.S. policy of limiting money supply. The difference in Japanese and U.S. interest rates surpassed the differences in inflation between Japan and the United States. Beginning in 1980 the yen-dollar exchange rate showed a strange movement. (See Note 6)

Note 6. We owe the above explanation to Mr Toshihiro Horiuchi who was in charge of the macro-policy in this research project.

Beginning in early 1980, the balance of the current account served as a factor for the low yen and the high dollar, the difference in the interest rate as a factor for the high dollar, and the difference in the inflation rate as a reverse factor for the high dollar. In reality, the high yen lasted until the first quarter of 1981. At times after that the balance of the current account between Japan and the United States showed strange changes.

But both were in the black and were rather impervious to the yen-dollar rate. But due to the extreme tight money policy and the lax financial policy of the Reagan administration in the United States, the difference in the interest rate increased. Thus in 1981 and 1982, the U.S. side denounced Japan for allegedly inducing a low yen, and the Japanese side countered that the financial and monetary policy of the United States caused a high dollar. Thus a controversy ensued.

The U.S. contention at that time was not necessarily accurate. In many cases alleged intervention on the part of Japan was suggested. The U.S. side claimed that while Japan was apprehensive about U.S. financial and monetary policy (that is, apprehensive over the extremely tight money and lax financial policy), yet the yen was still undervalued in the market, and suggested that this was due to such intervention on the part of Japan. (1) Such an example was seen in the argument of P. McCracken in February and March 1982 and at the Shimoda Conference in the summer of 1982. (2) Although of the same persuasion, in 1982, in showing the real and effective exchange rates of the major currencies, Morgan Guaranty Trust demonstrated that the yen was undervalued.

Although we cannot generalize on how and through what channels the Japanese side refuted the criticism, it contended as follows: (1) The current high dollar was caused rather by U.S. monetary policy. (2) Since 1977 Japan has promoted the liberalization of exchange rate control, and control was abolished with the new Exchange Control Law of December 1980. Furthermore, the Japanese Government, wishing to remedy the low yen, had rather moved for yen-buying. Also, the zero coupon purchase control which was practiced for a while was intended to prevent the low yen by preventing capital flow. And the Japanese Government contended that (3) because of apprehension over the low yen, it could not adopt a monetary policy for stimulating domestic demand, nor, because of the deficits, could it expand spending in finance.

Actually, the U.S. criticisms of the low yen were more in the nature of questions on market performance, and did not contend that the Japanese Government had intervened for a low yen. To expand implications made by the United States, Japan wants to open the market, because as things are it appears that either (a) Japan is expanding the balance of financial payments to cause a high yen and the growth of domestic demand or (b) otherwise the financial market is probably closed.

Ultimately, the U.S. presidential economic report in early 1983 demonstrated the belief that Japan had not clearly engaged in inducing the low yen, and emphasized above point (b). (NIHON KEIZAI SHIMBUN, 2 February 1983)

In fact, the change in the yen-dollar exchange rate during 1982 showed a difference from past workings of the supply-demand factor (the balance of the current account) in the foreign exchange flow, of the assets selection factor (the difference in the interest rate), and of the purchasing power factor (the difference in the inflation rate). Accordingly, the element of "expectation," which anticipated political risk and the increased import

restrictions against Japan seems to be large. Then, the U.S. posture of bringing pressure on Japan by causing friction also amounts to inducing a short-term weakening of the yen rate.

As can be seen in Table 1, clearly in 1981 and 1982, as a result of the tight money policy that the Reagan administration forced in order to break down "inflation expectations," the unemployment rate in the United States rose. At this time, the United States wanted to stabilize the yen-dollar rate at a certain value because that would cancel the effects of the recession at home by increasing the ordinary surplus. The reverse had taken place in 1978 when the yen was suddenly high. At that time, the United States feared a rise in the weak-dollar import prices would accelerate inflation at home, and ultimately defended itself with an anti-inflation policy and a government declaration for intervention.

In 1982, it was possible for Japan to respond by expanding domestic demand and increasing employment opportunities while preventing the low yen through the increased issue of government securities. On the other hand, in the United States there was an alternative for relaxing the rise of the unemployment rate while avoiding the high dollar by changing the financial and monetary policy mixture. (See Note 7)

Note 7. In 1981 and 1982 there seemed to be foreign zero coupon purchases and flight of capital in anticipation of the green card system (small savings card system) in Japan. In this sense, there seemed to be effective market reactions following the institutional change (although it did not take place).

Lastly, we should mention a political factor which brought about confusion in the macropolicy theory. During 1979 and 1980, the United States was preoccupied with the Iranian revolutionaries having taken U.S. Embassy personnel hostage, and it had to confront the Iranian Revolutionary Government. Japan finally cooperated with the United States and participated in economic sanctions against Iran, thus clearly showing its support for the United States. However, in the early period Japan hesitated because of its economic commitment to Iran. Furthermore, at the time of the Soviet invasion of Afghanistan, Japan announced its positive support for the United States and participated in the economic sanctions against the Soviet Union.

On the one hand the United States had to maintain a strong military force at home, but its national economy lost strength. On the other hand, the American people perceived that Japan, which was benefiting greatly from the U.S. defense efforts, was getting a free ride in matters of security in spite of the fact that it was strengthening its economic power. For this reason, there were strange and confusing debates between allied nations.

Although the balance of trade between the two nations and the equilibrium of the balance of the current accounts have no economic meaning themselves, the argument that in its balance of trade with Japan the United States cannot endure deficits beyond a certain level probably reflects the

politics in the economic relations between the two countries. (See Note 8) On the one hand, the United States stressed its alliance with Japan and criticized Japan's freeloading, and on the other hand it demanded an equilibrium of trade balance which will not create problems between allies.

Note 8. See Jones Report.⁷ We will not go deeply into it here, but if we view defense as a common asset of Japan and the United States, division of its cost will become an important point of argument. Certainly, increased defense spending is a big burden on the U.S. economy and its casts its shadow on the performance of the macroeconomy, too.

III. Friction in Commodity Trade

Friction in trade between Japan and the United States is generally divided into: first, friction over voluntary restraints on Japanese industrial exports; second, friction over residual quantitative import restrictions against Japanese agricultural and livestock products; and third, friction over aid to structural changes in manufacturing industries. In this section we will review these problems from the process of generating friction to the process of formulating countermeasures.

U.S. Import Restrictions Against Japan

As typical samples of Japanese commodity exports to the United States which caused economic friction in the 1970's can be mentioned fiber, steel (ordinary steel and specialty steel), color television sets, automobiles and numerically-controlled machine tools. Exports of these commodities to the United States are currently restricted or have been restricted in the past by Japan's voluntary export restraints (VER).

Of the fiber products exported from Japan to the United States, a long-term agreement (LTA) on cotton products was signed at GATT (1962), and voluntary export restraints had been enforced. Furthermore, the trade of woolen and chemical synthetic fiber products was discussed in connection with the presidential elections and the issue of the return of Okinawa. Finally with the Japan-U.S. fiber agreement (signed in 1971) Japan decided to enforce voluntary export restraint. Thereafter, in 1974 a new Japan-U.S. fiber agreement including cotton, wool, chemical synthetic was initialed based on the Multinational Fiber Agreements (MFA). Thus fiber products have been placed under a fully controlled trade called the voluntary export restraints for the United States. The industry had already begun to practice voluntary export restraints on ordinary steel materials in 1966. These voluntary restraints were extended several times and their contents were strengthened, and they lasted until 1974. Thereafter, in 1976, following economic recovery in the United States, U.S. imports of iron and steel materials were rapidly increased, and there were in the United States strong moves demanding import restrictions as a part of the iron and steel industry relief policy based on the Solomon report. The U.S. Government put into practice the trigger price mechanism (TPM) as a part of the iron and steel industry relief policy based on the Solomon report. (February 1978) (See Note 9)

Note 9. The trigger price mechanism is a system in which the production cost of the world's most efficient maker (currently Japan) with cost, insurance and freight added is set as a base, and when import prices fall below this price, there is an investigation to prove dumping. The objective of TPM is not to directly restrict quantities of imports, and it is said to have its merit in making the price mechanism function. But there is the criticism (1) that the method leaves room for tolerating dumping from countries other than Japan; (2) that it is not clear whether the production cost in Japan has been accurately computed; (3) that the method cannot cope with changes in the exchange rate; (4) that the setting of the trigger price itself approves increased iron and steel prices in the United States.

In the United States protectionist moves against Japanese-made color televisions took various guises such as suspicion of dumping, protective duties and unfair practices. But the U.S. Government finally asked Japan to enforce voluntary restrictions. As a result, from 1977 to 1980, Japan carried out voluntary export restraints for the United States. As to the export of automobiles, although there was a "no damage" verdict from the U.S. International Trade Commission and the Japanese automobile industry imposed unilateral voluntary export restraints, the Japanese and the U.S. Governments decided to restrict automobile exports.

Thus, in the 1970's alone, controlled trade such as voluntary export restraint and the trigger price mechanism emerged as major characteristics of Japan-U.S. trade. In the early 1970's, the magnitude of this controlled trade was about 15 percent of total Japanese exports to the United States, in 1981 it went as high as 40 percent with the enforcement of voluntary export restraints for automobiles also. (See Table 2)

In the past, tariffs, import quotas and other steps taken by an importing country were common. But in recent trade between the United States and Japan there have been many cases in which Japan, the major exporting country, has been asked to place voluntary restrictions on exports. The problem points in voluntary export restrictions are typically shown in the fiber trade. (See Note 10) First, even should the largest exporting country impose voluntary export restrictions, since the exports to the United States from other countries would increase so that the United States would have to ask third nations for voluntary export restrictions. Thus this voluntary export restriction system becomes multilateral. Second, a multilateral voluntary export restraint system has substantially the same effect on each exporting nation, and can lead to dangerous political discrimination violating the general safeguards of GATT which disapproves limiting imports from a particular country. Third, for the safeguard exercised by GATT, the originating country must make compensation but this compensation need not be made following voluntary export restrictions. Accordingly, the United States tends to easily request voluntary export restraint. Fourth, voluntary export restraint is supposed to be for a limited time period as its purpose is to give U.S. industry time to adjust. However, as Table 3 shows, the import ratio of

Table 2. Changes in the Controlled Trade Commodities to the United States (Millions of dollars, ¥)

| (A) 管理貿易対象品 | 1970 | 71 | 72 | 73 | 74 | 75 | 76 | 77 | 78 | 79 | 80 | 81 |
|-------------|---------|---------|---------|---------|---------|---------|---------|---------|----------|----------|----------|----------|
| 対米 毛織物 | 43.1 | 16.0 | 9.2 | 7.7 | 7.3 | 11.0 | 12.6 | 12.1 | 11.7 | 10.7 | 16.7 | 22.5 |
| ・ 合成・ | 81.5 | 107.7 | 99.2 | 101.2 | 107.8 | 121.5 | 155.8 | 168.1 | 201.8 | 152.4 | 161.1 | 271.8 |
| 綿・ | 40.9 | 37.2 | 61.6 | 28.5 | 26.5 | 18.9 | 30.4 | 32.4 | 30.1 | 25.4 | 35.2 | 49.0 |
| 対米 鉄鋼 | 899.0 | 997.0 | 1,034.2 | 959.9 | 2,077.7 | 1,845.1 | 2,050.7 | 2,310.7 | 2,384.1 | 2,739.2 | 2,761.7 | 3,985.8 |
| 対米 TV | 264.8 | 334.8 | 298.1 | 264.7 | 248.1 | 255.6 | 616.6 | 505.6 | 463.5 | 232.0 | 195.5 | 323.2 |
| ・ 自動車 | 537.9 | 1,158 | 1,365.7 | 1,622.6 | 2,175.5 | 2,281.1 | 3,529.5 | 4,925.6 | 7,030.2 | 8,246.0 | 10,118.8 | 11,255.9 |
| ①-④ | 1,867.2 | 2,650.7 | 2,868.0 | 2,981.6 | 4,642.9 | 4,533.4 | 6,395.6 | 7,954.5 | 10,121.4 | 11,405.7 | 13,229.0 | 15,908.2 |
| 対米輸出 | 5,940.0 | 7,495 | 8,848 | 9,449 | 12,799 | 11,149 | 15,690 | 19,717 | 24,915 | 26,402.5 | 31,367.3 | 38,608.8 |
| 日本の・ | 19,318 | 24,019 | 28,591 | 36,930 | 55,536 | 55,753 | 67,225 | 80,494 | 97,543 | 110,672 | 140,527 | 143,290 |
| 対米管理貿易額 | 939.9 | 1,034.2 | 1,204.2 | 1,097.3 | 2,219.3 | 1,996.5 | 2,249.5 | 3,026.9 | 3,091.2 | 3,159.7 | 2,914.7 | 15,585.0 |
| 7-8% | 31.4 | 35.4 | 32.4 | 31.6 | 36.3 | 40.7 | 40.8 | 40.3 | 40.6 | 43.2 | 42.2 | 41.2 |
| 10-8% | 15.8 | 13.8 | 13.6 | 11.6 | 17.3 | 17.9 | 14.3 | 15.4 | 12.4 | 12.0 | 9.3 | 40.3 |

Source: FOREIGN TRADE SUMMARY, December issues.

Key:

- A. Object commodity of controlled trade
1. Woolen goods to the United States
2. Synthetic textiles to the United States
3. Cotton products to the United States
4. Iron and steel to the United States
5. Color televisions to the United States
6. Automobiles to the United States
7. 1-6
8. Total exports to the United States
9. Total Japanese export
10. Controlled trade to the United States

industries concerned with voluntary export restraint does not increase much, nor do their shipments drop significantly, and adjustment in employment is considerably advanced. In spite of this, it will become an issue for Japan's voluntary export restraints to the United States to continue. (See Note 11)

Note 10. For a theoretical explanation of the effects of voluntary export restraint, see Takacs.⁸ It discusses the difference between the effect of import quotas and of voluntary export restraint in case there is an incomplete competitive factor in the export or import market.

Note 11. An example in which voluntary restraint on Japanese exports to the United States was not protracted is found in the case of color television sets. This was brought about by Japanese manufacturers of color television sets going into the United States and beginning local production after the voluntary export restrictions for the United States was activated. As shown in Table 3, among the problem industries, only the radiotelevision industry showed expanded employment.

Table 3. Changes in Industrial Structure in the United States

| | | 72 | 77 | 78 | 79 | 80 | 81 |
|------|------------------|--------|--------|--------|--------|--------|--------|
| (1) | 総雇用者 (2)10人 | | | | | | |
| (3) | 繊維 | 953 | 876 | 862 | 842 | 809 | 792 |
| (4) | 衣服 | 1,368 | 1,334 | 1,322 | 1,306 | 1,268 | 1,257 |
| (5) | 鉄鋼 | 543 | 521 | 526 | 536 | 475 | 494 |
| (6) | ラジオ、TV | 319 | 334 | 373 | 386 | 418 | 433 |
| (7) | 自動車 | 339 | 344 | 359 | 349 | 270 | 250 |
| (8) | 出荷 (1972年価格10\$) | | | | | | |
| (9) | 繊維 | 27,852 | 31,840 | 33,890 | 33,850 | 32,163 | 30,401 |
| (10) | 衣服 | 27,810 | 30,560 | 31,375 | 29,848 | 30,207 | 30,358 |
| (11) | 鉄鋼 | 28,102 | 27,798 | 29,351 | 30,381 | 25,519 | 27,000 |
| (12) | ラジオ、TV | 9,140 | 11,286 | 12,688 | 14,493 | 15,291 | 16,800 |
| (13) | 自動車 | 42,906 | 57,188 | 59,123 | 54,898 | 38,000 | 32,900 |
| (14) | 貿易輸入比率 | | | | | | |
| (15) | 繊維 | 4.7 | 3.7 | 4.3 | 4.0 | 4.3 | 4.9 |
| (16) | 衣服 | 6.7 | 8.3 | 10.2 | 10.4 | 10.9 | 11.5 |
| (17) | 鉄鋼 | 12.9 | 13.7 | 14.2 | 12.7 | 13.4 | 16.1 |
| (18) | ラジオ、TV | 3.0 | 7.9 | 5.0 | 4.8 | 5.1 | 6.1 |
| (19) | 自動車 | 7.6 | 9.5 | 12.2 | 13.7 | 20.3 | 18.1 |
| (20) | 日本の対米輸出額 | | | | | | |
| (21) | TV 10'台 | 1,116 | 2,135 | 1,537 | 686 | 570 | 1,023 |
| (22) | 鉄鋼 10'NT | 6,440 | 7,820 | 6,487 | 6,336 | 4,874 | 5,925 |
| (23) | 雇用者 10'台 | 590 | 1,339 | 1,409 | 1,547 | 1,819 | 1,806 |

Source: "U.S. Industrial Outlook," "White Paper on International Trade"

Key:

- | | |
|-----------------------------|--|
| 1. Total number of employed | 6. Radio-television |
| 2. 1,000 persons | 7. Automobiles |
| 3. Fiber | 8. Shipments (1972 price, \$1,000,000) |
| 4. Clothing | 9. Fiber |
| 5. Iron and steel | 10. Clothing |

- | | |
|---------------------------|---|
| 11. Iron-steel | 18. Radio-television |
| 12. Radio-television | 19. Automobiles |
| 13. Automobiles | 20. Quantity of Japanese exports to the United States |
| 14. Apparent import ratio | 21. Televisions, 1,000 sets |
| 15. Fiber | 22. Iron and steel, 1,000 NT [net tons] |
| 16. Clothing | 23. Automobiles, 1,000 automobiles |
| 17. Iron and steel | |

The following factors make up the background of Japan being requested to observe voluntary export restraint on industrial products to the United States: First, we find that in many cases performance of problem industries in the United States has deteriorated compared to Japan. Especially, many observers say that there are problems with U.S.-style management and the morale of U.S. workers. Since, taking the stockholders into consideration, U.S. managers pay more attention to short-term profits, they have not made long-term investments and have reduced the international competitiveness of their industries. Workers have also demanded wage raises far surpassing the growth of labor productivity. This large-scale hike in wages has been converted into a rise in product costs, and, it is said, has contributed to the drop in competitiveness against imported goods. (See Note 12)

Note 12. The hourly wage in the U.S. automobile industry was \$9.07 (in 1979), and \$6.69 in the manufacturing industries (in 1979). Automobile industry wages rank in the highest bracket, not just in the manufacturing industries but in all industries.

Secondly, at times there are sudden and rapid increases in exports of Japanese-made products to the United States (this is known as so-called concentrated torrential export) and U.S. industry sometimes cannot cope with such a sudden and drastic change. Within a few years after Japanese exports to the United States had shown a sudden increase, there arose a steady demand for protectionist measures such as voluntary export restraints within the United States and such measures were enforced. The export of iron and steel to the United States from Japan suddenly increased in 1968 and 1976. In 1969 the Japanese voluntary export restraints were strengthened and extended, and in 1978 the trigger price mechanism was adopted. Exports of color television sets were suddenly increased in 1976, and a voluntary export restriction system was put into force beginning in 1977.

The following may be considered to have caused the sudden increase in Japanese exports to the United States: (1) Sometimes there are export drives during recessions in Japan. (2) When there is an increase in domestic demand in the United States, capacity to supply does not increase because of the nonelastic response by U.S. industry to which we have referred and demand for overseas products, as, for instance, from Japan is increased. (For instance, the large-scale increase in the demand for color television sets in 1976 was considered to have been caused by the Montreal Olympic Games in the same year.) (3) U.S. industry cannot adjust to shifts in consumer demand. (The rise in energy costs turned the eyes of American consumers to Japanese-made small cars.)

The third point in the background is that the gap in economic power and technology between Japan and the United States has rapidly been closed. It was not only in the 1970's that exports of Japanese-made commodities to the United States caused friction with the United States but also before that there were times when gloves, metal tableware and other commodities became problems. While Japan was rapidly catching up with the United States, the competitiveness of U.S. industry gradually declined. In terms of friction-causing commodities, shifts were made from light industry products, such as fiber, to heavy industry products such as iron and steel and automobiles. Furthermore, if we consider even fiber and iron and steel as traditional commodities, the center of friction is shifting from these traditional commodities to such modern commodities as television sets and automobiles. Such a trend may be said to reflect the narrowing of the technological gap between Japan and the United States.

Japan's Residual Quantitative Import Restrictions

In the trade dispute between Japan and the United States, the United States always demands the lifting of Japan's residual quantitative restrictions. The number of items included in Japan's residual quantitative import restrictions was 90 in 1970. Thereafter, with the progress in import liberalization it was decreased to 27 in 1974. That has lasted up to date. The majority of the residual quantitative import restrictions are on agricultural and livestock products.

Of those items included in Japan's residual quantitative import restrictions, the United States aims particularly at expanding exports of beef and oranges to Japan and has asked Japan to liberalize these commodities. At the Tokyo Round this problem was discussed in the conference between the Japanese and the United States with the result that it was agreed to expand import quotas for beef, oranges and fruit juices, and specific import quotas until 1983 were announced. However, Japan and the United States have reached no agreement for 1984 and beyond. The recent U.S. demands are based on the premise of complete liberalization in beef and orange imports. Japan has responded to this by merely expanding import quotas and has avoided complete liberalization. It appears that this confrontation between Japan and the United States will not be resolved for a few years.

Basically, the United States seeks complete liberalization of beef and oranges, and demands that a bilateral conference be held at GATT headquarters. On three occasions from 1982 to 1983, Japan has taken steps to open up the market in response to the U.S. demand for liberalization, but it has not changed its basic stand on not liberalizing beef and oranges. Rather, Japan responds with the expansion of the import quotas on restricted import items other than beef and oranges, and by reducing tariffs on items of interest to the United States.

The following problems with beef and oranges have become the focal points in Japanese-U.S. trade negotiations: Some contend that even if Japan liberalizes these commodities, the increase in their import will be so small that it will not dissolve the trade imbalance between Japan and the

United States. They further contend that even if Japan increases beef imports, the import of feed grains from the United States will decrease, and that the increased beef imports may not necessarily come from the United States, but possibly from third countries such as Australia. However, even if there is only a small increase in imports of beef from the United States through liberalization, the criterion for the evaluation of policy improvement is not equilibrium in the trade balance between Japan and the United States, but in supplying cheaper beef to consumers and in accelerating the shift or adjustment to domestic producers.

Second comes the policy response on the part of Japan. It is problematic whether Japan would try to get around liberalization of beef and oranges by reducing tariffs on other agricultural and livestock products. Specifically, if protectionist measures for such processed products as fruit juices and juices are relaxed but protection of fruits, the raw materials from which they are made, is continued, prices for processed products will be lower and producers will have to pay more for raw materials. This is a policy of sacrificing processors for domestic producers of mandarin oranges and others who are expected to compete with imported oranges. If such a policy response continues, the effective rate of protection of processed products may drop below zero (Note 13) and also there may be reverse imports, brought about by processing cheap raw materials overseas and bringing the products into Japan (as in the case of Japanese sake and confectionery).

Note 13. For the effective rate of protection of the food processing industry, see Chapter 4 of Sueo Sekiguchi,⁹ and Shoda Yasutoyo.¹⁰

Next as for the producers in Japan, although a protectionist policy continues, there are signs that the adjustment of farmers related to beef and citrus has made considerable progress. According to livestock statistics, the number of farmers raising beef cattle in Japan was reduced by almost half from 670,000 families in 1972 to 350,000 families in 1981. Against this the total number of cattle raised has shown a smooth increase. This shows that the number of farmers with a large number of cattle for family use has been increased, and conversely, the number of small families raising cattle has been decreased. The number of farmers raising mandarin oranges to compete with the imported oranges was 370,000 families in 1971, but it was 300,000 families in 1980. Although there have been some fluctuations in the quantities of mandarin oranges harvested, quantities have generally been stable. Beef and mandarin orange producers in Japan have raised their productivity, but it is questionable whether they are internationally competitive. Policy response should be aimed at accelerating such adjustment domestically and at accomplishing import liberalization ahead of schedule internationally.

Friction in the Material Industries

In contrast to Japanese export goods to the United States causing friction in the U.S. market, as U.S.-made products are increased or are expected to

suddenly increase, Japanese production is threatened. Among such "reverse frictional" commodities are aluminum, petrochemical products, and other products of the basic materials industries. As shown in Table 4, imports of aluminum and its alloys centered on aluminum ingots from the United States have shown sudden and rapid increases during the past several years. Also, imports of the "organic compounds" mainly composed of petrochemical products from the United States have increased. Thus, in the background of the lowering of the international competitiveness of aluminum and petrochemical products is the change in the energy price system linked to petroleum.

Table 4. Imports and Industrial Structural Change in the Japanese Market

| | | | 1972 | 1976 | 1977 | 1978 | 1979 | 1980 | 1981 |
|------|-----------|---------|-------|-------|-------|-------|-------|-------|-------|
| (1) | 肉用牛飼育戸数 | 1,000戸 | 673.2 | 449.6 | 424.2 | 401.6 | 380.8 | 364.0 | 352.8 |
| (2) | 〃 頭数 | 1,000頭 | 1,749 | 1,912 | 1,987 | 2,030 | 2,083 | 2,157 | 2,281 |
| (3) | 牛肉輸入 | 1,000MT | 57.6 | 92.2 | 84.4 | 99.9 | 129.7 | 121.9 | 122.4 |
| (4) | みかん栽培農家数 | 1,000戸 | 371.0 | 341.6 | N.A. | N.A. | N.A. | 302.3 | N.A. |
| (5) | 〃 収穫量 | 1,000MT | 3,568 | 3,089 | 3,539 | 3,026 | 3,618 | 2,892 | N.A. |
| (6) | オレンジ輸入 | 1,000MT | 13.5 | 24.4 | 22.5 | 51.0 | 54.1 | 71.4 | 75.6 |
| (7) | 化学品 輸入 | 百万\$ | 1,148 | 2,662 | 3,003 | 3,763 | 5,178 | 6,202 | 6,487 |
| (8) | うち米国より | 〃 | 411 | 1,084 | 1,153 | 1,408 | 2,053 | 2,536 | 2,751 |
| (9) | 有機化合物 | 〃 | 209 | 625 | 669 | 884 | 1,464 | 1,679 | 1,847 |
| (10) | うち米国より | 〃 | 82 | 101 | 191 | 305 | 613 | 643 | 698 |
| (11) | アルミニウム、合金 | 1,000MT | 333 | 452 | 557 | 766 | 781 | 956 | 1,160 |
| (12) | うち米国より | 〃 | 18 | 40 | 14 | 42 | 110 | 321 | 277 |

Source: "Livestock Statistics," "Portable Agricultural, Fishery, Statistics," "White Paper on International Trade." a) = 1971

Key:

1. Number of farm families raising beef cattle, 1,000 families
2. Number of heads of beef cattle, 1,000 heads
3. Beef imports, 1,000 M/T
4. Number of farming families raising mandarin oranges, 1,000 families
5. Quantity of mandarin oranges harvested, 1,000 M/T
6. Orange imports, 1,000 M/T
7. Chemical imports, 1,000,000 dollars
8. From United States, 1,000,000 dollars
9. Organic compounds, 1,000,000 dollars
10. From United States, 1,000,000 dollars
11. Aluminum and its alloys, 1,000 M/T
12. From United States

Large volumes of electric power are consumed in the production of refined aluminum goods. There is a difference between Japan and the United States in the costs of electric power used in refining. As to the electric power for aluminum refining, because the United States depended on hydroelectric power and coal thermal power (about 80 percent), it had an advantage in the production of refined aluminum products. Such a trend was further intensified in the period immediately following the second oil crisis in 1977. Thus U.S. exports of aluminum ingots to Japan were suddenly and vastly increased. As a result, aluminum production in Japan was slowed down, and the manufacturers were pressed to dispose of a lot of production capacity. The Japanese Government designated the aluminum refining industry as a specific recessionary industry in accordance with the Specific Recessionary Industry Stabilization Law (Specific Stabilization Law) enacted in 1978, and attempted to promote the structural change of that industry. In doing this, the government tried to proceed with conversion from old facilities to new facilities, reducing production capacity through methods such as "scrap and build" used in converting old facilities into new ones. The government deemed it necessary to try to maintain normal imports because a short-term change in imports would not be favorable to the smooth promotion of plans for a shift in the process of carrying out the change of facilities. (Note 14) In 1978, the tariff quota system for aluminum was to last for only a year, but it was extended by a year and went on until 1979. Beginning in 1982 tariff on the ingots imported by aluminum refiners was exempted for 3 years.

Note 14. Refer to the recommendations of the Aluminum Division meeting of the Industrial Structure Council at the Ministry of International Trade and Industry.^{11,12}

As to the kind of contracts there are for aluminum imports to Japan, there are three kinds: developmental imports, long-term contracts and spot imports. Of these the main source of spot imports was the United States. Therefore, the Japanese Government, which attempted by means of contracts to discriminate in applying the tariff exemption system, encountered the announcement of a strong opposition from the United States, and the Japanese Government finally approved tariff exemption on all forms of import. (Note 15) What becomes problematic in the Japanese aluminum import policy in connection with the Specific Stabilization Law is that it tends to give excessive protection to domestic producers. In the tariff quota system, too, the framework for limiting imports on which a low primary tariff was applied was determined corresponding to the production capacity of facilities which would be abandoned according to the basic stabilization plan stipulated in the Specific Stabilization Law. The framework for exempting imports from tariff established in 1982 is similar. When the estimated production capacity of abandoned facilities is low, there is less application of low import tariff rates and fewer tariff exemptions, and more protection of aluminum ingot producers. On the other hand, sectors, like the rolled aluminum sector, which are the consumers of aluminum ingots are prevented from using cheap overseas ingots. As a matter of fact, the Specific Stabilization Law stipulates the establishment of a "specific industry recession fund" in order to accelerate the dismantling of

facilities in specific recession industries, and finally supports industrial structural change. However, the aluminum refining industry did not take advantage of this fund.

Note 15. On this point, see Customs Bureau, Ministry of Finance, "All About Tariff Revisions." (1982 edition)

Unlike in the United States, where petrochemical raw materials are cheap, petrochemical raw material prices were rather high because of the Japanese energy policy. Specifically, the policy (1) did not approve imports of naphtha by the petrochemical industry circles, and (2) set high prices for domestically produced naphtha. The background of this is that the government provided protection for the domestic petroleum industry. Up to this time Japan had followed the method of onsite refining of petroleum for consumption. Therefore, the government carried out policy intervention in accordance with the Petroleum Industry Law in such areas as reporting of crude oil imports and petroleum refining industry production, reporting of production plans, and inspection of facilities, and also set prices for domestically produced naphtha. Prices of this domestically produced naphtha were set higher than prices of naphtha produced in the oil-producing countries or in the newly emerging nations. Moreover, imports of cheap overseas naphtha were limited to the petroleum industry and were not approved for the petrochemical industry. As a result of such policy intervention, the petrochemical industry used considerably high-priced raw materials, prices of its products also went up, and their international competitiveness was lowered. (Note 16)

Note 16. Beginning in 1982 prices of domestically produced naphtha were set in linkage with imported naphtha.

On two occasions large-scale rises in the price of petroleum brought about changes in the production and import of petrochemical products in Japan. In Japan ethylene was produced from naphtha which uses crude oil as its raw material, and from this ethylene various petrochemical products were produced. Against this, U.S. chemical products did not depend much on naphtha. They were produced by using ethane which is a main constituent of natural gas. The rise in the prices of naphtha in Japan brought about a rise in the production costs of ethylene derivatives. Especially, prices of vinyl chloride, ammonia, synthetic fiber materials, and the like, and of imports of low-priced chemical products from the United States and Canada increased.

That the international competitiveness of the Japanese petrochemical industry was reduced was not only because it depended on different raw materials but also because of the impact of administrative interference by Japan and the United States respectively. Since the oil crisis the prices of petroleum and natural gas in the United States had been regulated and their rise in price was controlled. Price controls on petroleum were abolished only in 1981. But the price control of natural gas is still in effect in order to protect consumers. Price controls on natural gas are expected to be abolished by 1985, but some believe deregulation will be difficult. Since

In the United States petrochemical products were produced using natural gas, the price of which was kept low as a matter of policy, as raw material, exports of these products to Japan increased. This has put some quarters in the Japanese petrochemical industry on guard, and, to protect ethylene glycol or acrylonitrile, which are raw materials for synthetic fiber, they are considering filing charges of dumping. (See Note 17)

Note 17. See Nihon Keizai Shimbun, 13 March 1983.

Some parts of the chemical industry including ammonia and urea have been designated as specific recession industries in accordance with the Specific Stabilization Law, and these are proceeding with structural change. As this Specific Stabilization Law expires in June 1983, the government is attempting to enact a new temporary law for the structural improvement of specific industries, (Structural Improvement Law = new specific stabilization law), and to accelerate industrial structural change. In the new structural improvement law, the petrochemical industry which has not been legally designated as a recession industry will be newly added. However, even in the new structural improvement law, the cooperative action in the disposition of facilities is exempted from the application of the antitrust law. There is a strong demand in the industry for exempting even such cooperative actions as business cooperation (including merger) from application of the antitrust law. However, although it was not stipulated in the Specific Stabilization Law, the new structural improvement law will add that the Ministry of International Trade and Industry and the Fair Trade Commission must make prior adjustment for business cooperation.

The United States is intensifying its guard against this new structural improvement law by claiming that there is a danger of protecting and preserving declining industries in Japan. Specifically, Mr Brock of USITR (Office of the U.S. Trade Representative) who visited Japan last February criticized this structural improvement law, saying, "It goes against true trade liberalization. A cartel designed to isolate inefficient domestic enterprise from foreign enterprises also goes against Japan's commitment to free trade." Also, the U.S. Government clarified the view of the Antitrust Division of the Justice Department that "the market should decide which enterprises among declining industries should be withdrawn and how the field should be reduced." (See Note 18) In essence, in Japan, government and industry in collusion try to implement industrial structural change. But the thinking of the U.S. side on industrial structural change is that structural change at the industrial level must be rejected like a cartel and should be carried out by individual enterprises regulated by the market. Thus, there is a fundamental difference in thinking between Japan and the United States on structural change in the materials industries, and this seems to be the basic cause of friction.

Note 18. Nihon Keizai Shimbun, 3 and 13 February 1983.

IV. Industrial Policy, Economic System and Friction

In this section we will deal with friction generated by the fact that the two countries, Japan and the United States, have different domestic industrial policies and systems. The origins of strife are diverse. A well-known instance is that while in Japan the government aids certain sectors by terming them formative industries, the U.S. Government denounces this as unfair competition, saying that it never does anything like that. But in this article we will focus on friction generated by enterprises which extend their businesses into each other's country by crossing its boundary.

In examining friction among industries we will focus on the banking and securities industry, the distribution industry and international aviation service.

The Banking and Securities Industry

Friction is caused as it is contended that there is a difference between the degree of freedom of activity which Japanese banks and securities companies enjoy in the United States and the degree of freedom that U.S. companies enjoy in Japan. (See Note 19)

Note 19. We owe this part particularly to the study by Mr. Yo Arai.

First, in the securities industry, both the Tokyo and New York stock exchanges had excluded foreign companies from membership. But in 1977 New York changed this and opened the exchange to subsidiaries of foreign companies. As a result of this, Nomura Securities American became a member of the New York Stock Exchange in 1981. On the other hand, in Japan (1) in terms of regulation subsidiaries of foreign companies could become members beginning in April 1982, but membership rights were limited, surplus demands were high, and purchase costs were so high that in practice they could not become members. (2) The rebate of consignment fees for selling and buying stocks was 27 percent for nonmembers, and was 75 percent for subsidiaries of foreign companies. But it is now 27 percent for both, and there is no difference for nonmembers. (3) In the issue of yen-denominated securities subsidiaries of foreign companies are excluded from participating in managing companies in accordance with the administrative guidance by the Ministry of Finance. As the result of this practice, their profit markedly decreases. (Note 20)

Note 20. There also seems to be the complaint that subsidiaries of foreign companies can become members of the Japan Securities Dealers Association, but that they cannot join committees within the association. Complaints like this, like the one that they cannot join the Japan Architects Association, are too numerous to be counted. (See Kansai Economic Center¹³) But this kind of problem at the private level should be taken care of by private parties. The cost and benefit of participation and nonparticipation should have been computed by each entity concerned.

On the other hand, for the banking industry, compared to the strict regulation of the market in Japan, Japan has treated foreign banks as guests. Their preferred treatment consists of (1) the regulating framework for converting foreign currencies to yen is generous; (2) foreign banks have advantages in the framework for issuing certificates of deposit; (3) foreign banks are also exempted from window guidance in the fund taken in the call and bill market; and (4) foreign banks are deferred for 5 years from application of the New Banking Law of 1982 regarding control of large loans.

In spite of such preferred treatment the business records of foreign banks have deteriorated. Basically, before 1973 capital management was advantageous to foreign banks, but thereafter demand for funds declined and things came to a point at which foreign banks could not penetrate financing and enterprise groups. They even lent money to companies which gave loans to salaried workers, and wound up with bad debts. Also through the liberalization of impact loans they rather lost the benefits of their privileges as foreign banks. There are foreign banks of many nationalities. But at least U.S. banks are seeking opportunities for various kinds of activity at the level of free activity available to Japanese banks in the United States. As a specific instance, foreign banks can liberalize at least foreign-to-foreign transactions through the liberalization of loan issues and the creation of the Tokyo offshore market. The creation of a Tokyo offshore market is currently under study, but liberalization of loan issues is naturally encountering strong resistance as it infringes on the privileges of certain banks in Japan.

Distribution of Industry

As for the sources of friction, there are three general categories. First, the U.S. side makes the criticism that various producer cartels in Japan are keeping imports down. In 1982, there were four legal "import cartels" in Japan: for corn, Australian sugar, onions from Taiwan and silk textile from certain regions. These cartels clearly have import restrictions themselves, either based on agreements between governments or in response to cartels in exporting countries. But they are not objects of controversy between Japan and the United States. (Note 21)

Note 21. It is ironic, but concomitant with the U.S. request for voluntary export restraints, export quotas naturally became necessary and there was an increase in the number of cartels for export transactions by exporters. As of the end of 1982 there were 12 such cartels.

The problem is rather with "recession cartels," "rationalization cartels," and cartels of small and medium enterprises for the stabilization of business. The first two types of cartel were legally recognized by the Antitrust Law of 1953. At that time imports were subject to foreign exchange allocation, and the formation of recession cartels was approved. If the cartels engaged in cooperative actions to reduce production, they were required to accomplish the expected purposes of controlling supply and

raising prices. However, since imports have not been liberalized, as long as import competition exists, their action is supposed to lead only to replacing the production lost in Japan with imported goods. In this sense, even if Japan argues to the U.S. side that "recession cartels" have no controlling effect on imports, the American doubts will not be dissolved.

In practice there was a decrease in recession cartels, but in 1982 eight were approved because of the 1982 recession, and three remained at the end of the year. (Table 5) They were for the shipbuilding industry, vinyl chloride resin, short-fiber yarn, high quality paper, coated paper, printed kraft paper, medium and low density polyethylene, short fiberglass boards, long fiberglass boards. Cooperative actions are substantially restricting production from the various facilities.

Table 5. Major Cartels Exempt From the Application of the Antitrust Law

| (1) 毎年3月末 | 1955 | 1960 | 1965 | 1970 | 1975 | 1980 | 1981 | 1982 |
|---------------|------|------|------|------|------|------|------|------|
| (2) 再カルテル | 0 | 4 | 2 | 0 | 2 | 1 | 1 | 3 |
| (3) 合理化カルテル | 0 | 9 | 14 | 10 | 0 | 1 | 1 | 0 |
| (4) 中小企業団体 | 143 | 370 | 587 | 469 | 511 | 267 | 268 | 290 |
| (5) 輸出業者の輸出取引 | 14 | 129 | 139 | 133 | 63 | 44 | 42 | 41 |
| (6) 輸入業者の輸入取引 | 0 | 2 | 2 | 4 | 4 | 4 | 4 | 3 |
| (7) 特定不況産業 | | | | | | 8 | 8 | 4 |

Note: There are other legal cartels in such industries like those for developing the electronics industry and for the stabilization of chemical fertilizer business.

Source: Fair Trade Commission, "Annual Report for 1981," 1982.

Key:

- | | |
|--------------------------------------|-------------------------------------|
| 1. End of March of each year | 5. Export transactions of exporters |
| 2. Recession cartel | 6. Import transactions of importers |
| 3. Rationalization cartel | 7. Specific recession industries |
| 4. Small and medium enterprise group | |

As in the case of shipbuilding, when export allocation is made because of the worldwide recession with the result that in Japan production is reduced through cooperative actions, the expected purposes are achieved, even though Japan has comparative superiority in this field. But when the reduced production is replaced by imports, the cartel is ineffective. (Note 22)

Note 22. If a cartel is effective, it means that the industrial structure in Japan is not competitive because of the existence of enterprise groups. Moreover,

a rationalization cartel is designed to allocate technological development among member enterprises and thus to utilize accomplishments. It has the effect of causing a turnaround in the transactions between outsiders and members. There was one for synthetic fiber dyes in 1981, but none in 1982.

More massive actions by recession cartels are observed in cooperative actions taken by small and medium enterprises to stabilize business. These are not designed to engage in actions to restrict imports, but depending on the circumstances they control outsiders in accordance with "stabilization orders" from the Ministry of International Trade and Industry. If attempts to relieve enterprises engaged in certain activity by measures to reduce imports are not included, reduction of production only causes replacement by imported goods.

The second type of cartel has no particularly discriminatory effect on imported goods, but protects small retailers which increase the distribution margin and hold down consumption volume. The liberalization of direct investment in retail industry was delayed. Even in general retail, only in 1972 and in the case of fewer than 11 retail stores was it decided to allow 100 percent foreign investment. Thereafter, by the time of the fifth liberalization of capital which was completed by May 1976, everything was liberalized.

However, in Japan very large-scale retail stores, including supermarkets, were placed under control (1973). Furthermore, beginning in February 1982, under pressure from small retail stores, the opening of new branches by large stores was strictly controlled. Needless to say, in what form foreign retail stores will advance into Japan is dependent on their own choice. So far, they have in many instances taken the form of cooperation with large domestic retail stores. If, however, foreign retail stores step up their participation, it is bound to cause conflict with domestic control. Here also is the tendency, as in the finance industry, to grant national treatment but not to grant conditions as free as those offered by the trade partner at the time of acceptance.

Third is the criticism that the entry of foreign-made goods is difficult due to the liberalization of distribution by producers. We have scant accurate information on the scale of the corresponding U.S. market and corresponding U.S. industrial structure, but according to Hajime Sato,¹⁴ with the exception of the gasoline and automobile fields, U.S. distributors independently select commodities to be handled. Against this, according to the Fair Trade Commission, manufacturers of automobiles and home electric appliances are strengthening linear control by building capital and personnel connections. Although the Fair Trade Commission takes action to restrict overseas competition and the unjust exercise of power on the part of manufacturers, and corrects and guides them, it has little effect on the market structure in Japan because in itself investment in the sales fields by manufacturers does not constitute a reason for obstructing. (Note 23)

Note 23. International comparison of the antitrust laws in the distribution field is provided by the Fair Trade Commission,¹⁶ but there seems to be no big difference between Japan and the United States in the stance of the law itself.

Aviation Service (Note 24)

The aviation agreement between Japan and the United States was concluded in 1952. Since then the Japanese side has claimed that it is an unequal agreement, that compared to the number of U.S. lines into Japan and the exercise of the U.S. rights to carry traffic beyond, the Japanese side has been granted only limited access. Following are some of the specific details at this point in time.

(1) Japan exercises line rights in the United States consisting of 2 departure points and 7 arrival points, while the United States exercises line rights in Japan consisting of 20 departure points and 3 arrival points. The Japanese side considers this unequal. However, beginning in April 1983, Japan will gain two additional arrival points and the United States, one arrival point. (2) As for rights beyond, in addition to Tokyo-New York-Europe, Japan will add only Tokyo-Los Angeles-Rio de Janeiro beginning in April 1983. Against this the United States can freely exercise its rights beyond Japan as long as it gains an agreement of the countries to which it flies. (3) In regard to transport capacity which is determined by number of seats and number of flights, the Japanese side claims that the "post facto screening method" demanded by the United States has been forced on Japan. Also, as to fares, the Japanese side supports cartel fares determined by the IATA [International Air Transport Association], and the U.S. side advocates introduction of the principle of competition. Also in regard to the number of participating enterprises, the U.S. side opts for a flexible response, while the Japanese side holds on to one company, Japan Air Lines.

In air transportation service can be offered in a safe and convenient form and at a low price which guarantees normal profit for the enterprises, it is desirable for passengers and freight of all nations to be transported without discrimination and with competition. Judged from such an economic standard, the U.S. contention for the "freedom of the sky" is unilaterally mercantilistic, with its own market as an exception, in regard to the handling of the line rights and beyond rights. Against this, since the Japanese side represents one company, Japan Air Lines, on matters concerning international aviation, the Japanese side becomes weak kneed in aviation negotiations, and tends to stick to the ideas of contract and equilibrium appropriate to that company's capacity for offering services. (Note 25)

Note 24. We owe this part extensively to the study by Mr Yoshie Yonezawa.

Note 25. In the foregoing discussion we have not made reference to world rules concerning regular international

aviation. For these, please refer to commentaries written by specialized commentators. For instance, Takeshi Tsuzaki.¹⁷ Just because one side has equal numbers of arrival and departure points depending on the size of the national land, it cannot be said to share an equal opportunity for profit. But, it is unequal for one side to approve free beyond rights for the other, while the other extremely restricts such rights. In this sense, the United States is closed.

V. Lessons To Be Considered

For our review from the beginning to the last section we can draw several lessons.

First, in the field of macroeconomic policy (including the exchange rate), pretty much according to the view of specialists, Japan and the United States have not necessarily denounced each other that harshly in the friction in recent years. Practically, misdirected criticisms tended to be discussed in administrations and legislatures and tended to be exaggerated by the mass media. The United States clammed up for the first time with the presidential economic report drafted by Feldstein in early 1983. If there had been an exchange of information and views between the two nations, Japan and the United States, with reliable specialists participating, problems could have been handled far more constructively.

Recently as the doubts about the role played by the change in the exchange rate in the adjustment of the balance of the international payment have been strengthened, the revision of the market fluctuation is being discussed in consideration of the adjustment costs of the national economy. We lack powerful alternatives, but as to the friction between Japan and the United States, if the two nations had established an expert monitoring and review system, they could have made much more improvement in the situation.

Second, what are the lessons from the friction in economic trade? In several fields of industrial goods the United States clearly deviates from GATT rules on import restriction. However, as became widely known in about 1978-1979, the tendency toward aggressively practicing liberalization since Japan was a promotor of free trade seemed to have changed totally to the tune of "Japan is closed" coming from the United States and Europe. In other words, mutual understanding between Japan and the United States has disappeared totally.

While the Japanese Government has cooperated with the United States to earn time for certain industries in the United States to adjust, the United States has continued its offensives to make one after another criticism of Japan. Through this process, the impression has been strengthened in the world that Japan is weak in its world dealings or in those with the United States. What controls the tyranny of a big power is the possibility of "retaliation." But in reality, possibility of taking revenge on the United States is extremely remote.

The weakness on the part of Japan is that it is continuing with excessive protection for certain industrial goods be they citrus or beef. Also, in the manner of debate, as the U.S. side also conducts wrong debates "for the balance in the trade between Japan and the United States," bilateral negotiations have limited effects even if Japan liberalizes. This is only an end reply. This is not the problem. But it has the symbolic meaning that the market has been closed. Ideally speaking, Japan should unilaterally declare uniform liberalization measures and put them into practice.

Third, let us draw lessons about the handling of friction related to the domestic policy, control and system that are coming to the foreground in the mutual advance of enterprises. First, as a general principle what do we think of reciprocity and national treatment? National treatment is the basic principle in the sense that each has its own different cultural and social background and in their actions foreign nationals and enterprises should be largely regulated by the territorial principle. But even if we assume that the United States is a country free from control and Japan is the reverse, in the Japanese-U.S. relations now current, it would still be unreasonable for Japan to do things in the Japanese way. The situation of Japan not granting U.S. enterprises (even though they are treated like domestic enterprises) the freedom that Japanese enterprises enjoy in the United States cannot last forever. (Note 26)

Note 26. Frequently such mutually unequal conditions between advanced nations and developing nations are approved. Also, as Japanese enterprises see it, the freedom recognized in Japan by the Antidiscrimination in Employment Law is restricted in the United States. Also depending on the laws of states harsher regulations than in Japan are applied. In this sense we have qualified this statement with "if we assume."

Naturally, depending on problems we understand that local rules are necessary. Let's take the instance of environmental control. In this dimension it is not rational to make rules common to both Japan and the United States.

On the other hand, as can be seen in the Japanese securities industry, participation is regulated for unjustifiable purposes, and sometimes purposes are acceptable but regulations are inappropriate. Such efforts to improve policy was brought up for the first time when the friction surfaced.

Lessons from this article are that we should take positive steps to tackle this friction, and promote comprehensive study by Japan and the United States. The reason why we need comparative studies is that we need adequate prior studies in case we adopt reciprocity in the matter of national treatment, taking a more open direction. On this score, a good reminder to us is an instance in the late 1960's when knowledge was increased by joint international study of nontariff barriers while suspicion had prevailed before.

Another point to be stressed is that we should mobilize people as broadly as possible to record frictional phenomena and try to improve and publicize results. For, as in the case of Japan-U.S. aviation negotiations when friction is handled by the parties involved and a handful of bureaucrats and specialists, the publicity on the issue is reduced under pressure from interest groups which pursue the problem, and valid solutions cannot be attempted. Some bureaucrats may think that recording public debate on individual policy problems and broadly circulating the records may provide clues for the criticism of decisionmakers and may serve as a cause of new friction. Reality is the opposite. As seen from Europe and the United States the paucity of public means of understanding the background of problems in Japan sows seed of doubt.

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ECONOMIC

ECONOMIC RELATIONS WITH CHINA DISCUSSED

Tokyo SEKAI KEIZAI HYORON in Japanese Mar 83 pp 48-55

[Article by Satoshi Imai: "Construction of China's Socialist Economy and Sino-Japanese Economic Relations"]

[Text] Introduction

Premier Zhao Ziyang, reporting at the National People's Congress on the Sixth 5-Year Plan (1981-85), said that although the economic readjustment that has been underway since 1979 has become a long-term matter, it has garnered a great deal of success; he affirmed that it has shown up quite well in comparison with the many countries suffering an economic slump under a worldwide recession.

Also, at the preceding 12th Party Congress in September, Chairman Hu Yaobang proposed the imposing long-term strategic objective of quadrupling the total value of industrial and agricultural production by the year 2000. The fact that China is setting up the framework for such a great long-term strategic objective and has given the final stamp of approval to the Sixth 5-Year Plan demonstrates that the Deng Xiaoping-Hu Yaobang regime which was formed in the middle of 1981--having as a background the achievement of some results due to the economic readjustment and with the 12th Party Congress as a turning point--has begun dealing once again in determined fashion with the building of the economy over the mid- to long-term.

And in building the economy, the course to take is one of actively making use of foreign economic links such as trade and the importation of foreign capital; in this respect, the relations between Japan and China should come to play a more and more important role.

1. Results From Economic Readjustment

Improving Economic Indicators

The main economic indicators demonstrating China's economic achievements in recent years are shown in Table 1. Its economic record from 1979 (when the 10-year plan, which although faced with shortages of capital, goods, energy and foreign currency still envisaged a high level of growth, was scrapped and a move was made to the "eight character policy" of "readjusting, restructuring,

consolidating and improving" to 1982 is one of a certain degree of success as a whole (although in 1979 and 1980, there were large fiscal deficits and inflation). When this record is compared with that of the economies of the various nations of the world in 1981 or 1982, after the second oil crisis, this difference becomes even more striking. Whether an advanced industrial nation, a developing nation or a socialist nation, the economies of many countries stagnated during these 2 or 3 years, with zero or negative growth rates, or at best the growth rates reaching only 2-3 percent. Even for semi-developed countries which had continued high growth, the record was only around 6 percent. They face not only a dropping growth rate but also large fiscal deficits, a high rate of inflation and unemployment, and a sudden increase in their accumulated foreign debt and other economic difficulties, and many countries are in a situation wherein they are unlikely to extricate themselves easily from these difficulties in the near future.

Table 1. China's Main Economic Indicators

| | Units | 1973 | 1979 | 1980 | 1981 | 1982 | (est) 1983 |
|--------------------------------------|-------------------------|-------|--------|--------|-------|--------------------|---------------|
| | Compared with last year | | | | | | |
| National Income | | 12.0 | 6.3 | 9.2 | 3.0 | -- | -- |
| (1) | percent | 12.3 | 8.5 | 7.2 | 4.5 | 7.6 | 4 |
| (2) | percent | 13.5 | 8.5 | 8.7 | 4.1 | 7.4 | 4 |
| Heavy Industry | percent | -- | 7.7 | 1.4 | -4.7 | 9.3 | -- |
| Light Industry | percent | -- | 9.6 | 18.4 | 14.1 | 5.6 | -- |
| (3) | percent | 8.9 | 8.6 | 2.7 | 5.7 | 8 | 4 |
| Government deficit | billion yuan | 10.2 | -170.6 | -127.5 | -25.5 | -30 | -30 |
| (4) | percent | -- | 15.5 | 11.7 | 2.3 | 2.7 | 2.4 |
| (5) | percent | 0.7 | 2.0 | 6.0 | 2.4 | -- | -- |
| (6) | percent | 5.3 | 5.5 | 3.6 | 2.6 | -- | -- |
| Balance of payments | billion yuan | -19.7 | -31.2 | -27.6 | -0.1 | 53.3* (end Sep) | -2.9 |
| Foreign Currency Reserves (year end) | billion dollar | 15.57 | 21.54 | 26.62 | 47.73 | 92.28 | -- |

(1) Total value of agricultural-industrial products. (2) Total value of industrial products. (3) Total value of agricultural products. (4) Deficits as a percentage of revenue. (5) Rate of increase in retail prices. (6) Percentage not as yet employed. *estimated.

In contrast, in the case of China, the national income registered a low growth rate of 3 percent in 1981, but it has risen to an estimated 6 percent in 1982. Judging by the publicly revealed figures, the fiscal deficits decreased from 17.06 billion yuan (15 percent of revenue) in 1979 to the level of 3 billion yuan in 1982, in addition to which the decrease in revenue compared with the previous year switched to an increase in 1982 (although, as will be the following, the real deficits in national public finance did not decrease that much).

In China, which prided itself on having an inflationless economy, inflation finally appeared in 1979; the rate of increase in retail prices reached 6 percent in 1980, engendering a feeling of crisis. However, through the execution of a number of price-restraining measures, the rate of increase in retail prices came down to 2.4 percent in 1981, and it shows signs of having been held to a slight increase over the previous year in 1982. The percentage of "workers as yet without jobs" (unemployment rate), peaked at 5.5 percent in 1979, and it dropped to 2.6 percent in 1981.

Shift to Being a Creditor Nation

In its foreign economic relations, China has started bringing in foreign government loans, but not yet on a very large scale; in 1982, in contrast with an estimated valuation of exports of 36.94 billion yuan, repayments on loans came to 4.97 billion yuan. The debt repayment ratio is only 13 percent, well below the danger line of 20 percent, and if one considers the incoming foreign currency from tourism, export of labor and so forth, and remittances from overseas Chinese, this ratio drops still further.

The balance of payments, which showed large-scale deficits during 1980-82, appears to have registered a surplus of around \$4 billion in 1982 due to the efforts to control imports and increase exports. As a result, the foreign currency reserves increased from \$1.56 billion in 1978 to \$9.23 billion in September 1982, ranking ninth in the world as a whole, and second to Saudi Arabia (an oil-producing nation) among developing nations. And now it is making its appearance as a lender of capital in world financial markets; it is thought that its lending is greater than its borrowing of funds, as are its interest receipts over interest payments. In addition, it has 12.67 million ounces of gold reserves: calculated at the current quotation of \$490 an ounce, this would come to \$6.2 billion.

Furthermore, there is considerable improvement regarding inequalities among agriculture, light industry and heavy industry, and in the field of capital accumulation and consumption, which was the initial target of economic readjustment. Regarding the rate of capital accumulation, there was a great deal of argument at one point over whether 25 percent was the correct rate, but recently 25-29 percent has been considered correct. The rate of accumulation went down to 22.8 percent in 1981, but the goal is 29 percent for 1985.

As indicated, the signs of improvement due to the economic readjustment policies of the last few years are many. However, among the accomplishments that China has made public there are some exaggerations, due to internal political

considerations, and in reality it appears that the picture is not quite so optimistic. This is also indicated by the fact that the economic readjustment efforts initially scheduled for a period of 3 years have been extended to 1985, and that it will take another 5 years, from 1983 to 1987, to see a fundamental turn for the better in the fiscal economic situation.

The failure of the fiscal economic situation to experience a fundamental turn for the better is due to the "potential danger" often discussed up to the beginning of 1982, the deficit trend in government revenues and expenditures, centered around a lack of basic construction investment capital, the energy shortage, and the problem of prices.

The fiscal problems are the greatest problem for the present. This is because, as has been said, although the publicly announced fiscal deficits on the surface show a large-scale reduction, the public liability regarding the national bonds and foreign loans are not included in the deficit; when these are included, in 1982 the percentage of revenue required to cover the deficit was 11 percent, so it is still at a rather high level.

2. Long-Term Strategic Objectives and the Sixth 5-Year Plan

Long-Term Goals Aiming at the Year 2000

During the latter half of last year, there were two events of importance to China in the building of its economy. One was the presentation of the long-term strategic goals for the year 2000, and the other was the adoption of the Sixth 5-Year Plan.

At the party conference last September, the long-term strategic goal presented by General Secretary Hu Yaobang, assuming an unbroken advance in economic efficiency, was to quadruple the total value of industrial and agricultural production in the 20 years from 1981 to the year 2000, that is, to increase the 700 billion yuan of 1980 to about 2.8 trillion yuan in the year 2000. If this goal is fulfilled, the total production and the amount of key industrial goods production will be in the world's front ranks, and the standard of living will reach a "respite level" (a medium level).

A quadrupling in 20 years comes to 7.2 percent per year. Dividing this into two stages--the first 10 years and the second 10 years--based on the consideration that in the eighties the conditions restricting economic growth will remain severe, the first 10 years will go to strengthening the foundation, saving power, and meeting all the various conditions; then, a fresh economic awakening is expected in the second 10 years. Putting it in terms of growth rate, the yearly rate for the first 10 years will be 5-6 percent, while in the 1990's it is envisaged that the value of total industrial and agricultural production will be 1.7 times that of the 1980's, reaching 8-10 percent in the second 10 years. In addition, in the 10 years of the 1980's, it appears that the planned growth rate is 5 percent in the Sixth 5-Year Plan (not a formal goal, but a goal to strive toward in the process of execution) and 6 percent in the Seventh 5-Year Plan.

Table 2. Sixth 5-Year Plan Long-Term Strategic Goals

| | Units | Recorded, 1980 (1980 values) | Goals for 1985 | | Goals for 2000 | |
|------------------------|-----------------|---------------------------------|----------------------------------|-------|-----------------------------------|----------------------|
| | | | Percent of Yearly Growth Rate | | Multiple Yearly Rate (Percent) | |
| G N P | billion dollar | 283.2 | -- | -- | -- | -- |
| | billion yuan | 428.1 | -- | -- | -- | -- |
| National Income | billion yuan | 366.7' | 44.5 | 21.4 | 4' | -- |
| (1) | billion yuan | 715.9' | 871 | 21.7' | 4' | 7.2 |
| (2) | billion yuan | 497.2' | 605 | 21.7' | 4' | -- |
| (3) | billion yuan | 263.9' | 305.9 | 15.9 | 3' | -- |
| (4) | billion yuan | 233.4' | 297.9 | 27.6 | 5' | -- |
| (5) | billion yuan | 218.7' | 266' | 21.7 | 4' | -- |
| (6) | million tons | 320.52 | 360' | 12.3' | 2.3 | 1.56 |
| Population | millions | 982.55 | 1,060' | -- | 1.3' | 1.22 |
| (7) | yuan | 383 | 420 | 9.7 | 1.9 | -- |
| Per Capita GNP | yuan | 436 | -- | -- | -- | -- |
| | dollar | 290 | -- | -- | -- | -- |
| (8) | billion yuan | 108.5 | 127.4' | 17.4 | 3.3' | -- |
| Government Expenditure | billion yuan | 121.2 | 130.4' | 7.6 | 1.5 | -- |
| Foreign Trade* | billion yuan | 56.6 | 85.5' | 51.8 | 8.7' | -- |
| | billion dollars | 37.82 | 57.41 | 51.8 | 8.7 | 160 |
| Energy ** | million tons | 637.2' | 682.9' | 7.2 | 1.4' | 1,274.4 |
| Coal | million tons | 620.15 | 700' | 12.9 | 2.5' | 1,200 |
| Petroleum | million tons | 105.95 | 100' | -5.6 | -1.1 | 200 |
| Electric Power | billion kw | 300.6 | 360 | 20.4 | 3.8' | to industrial growth |
| (9) | billion ton | 1,112.79 | 1.2' | 10.5' | 2' | -- |
| (10) | million tons | 37.12 | 39' | 5' | 1 | 74.24 |
| Cement | million tons | 79.86 | 98' | 23' | 4.2 | 159.72 |
| Chemical | | | | | | |
| Fertilizer | million tons | 12.32 | 13.4 | 8.8 | 1.7 | 24.64 |
| Cotton Thread | million tons | 2.93 | 3.59' | 22.8' | 4.2 | 5.86 |
| Cotton Cloth | million meters | 13.5 | 15.3' | 13.3 | 2.5 | 107 (sic) |
| Paper | million tons | 5.35 | 6 | 12' | 2.3 | -- |
| (11) | million tons | -- | -- | -- | -- | 4-5 |
| | | | | | | 7.2-8.4 |

(1) Total value of industrial agricultural production. (2) Value of total industrial production. (3) Value of heavy industrial production. (4) Value of light industrial production. (5) Value of agricultural production. (6) Output of foodstuffs. (7) National income per capita. (8) Government revenue. (9) Value of rail freight transportation. (10) Blisters steel. (11) Machine industry goods. *Indicates figures given in the Sixth Plan. **Includes both imports/exports. **Based on standard conversion rate.

Since the announcement of the long-term strategic goals, there has been a great deal of discussion within China as to the possibilities for their realization. The public discussion in China naturally all affirms that realization is possible. However, these goals are no more than a loose framework, and it remains to be seen what concrete form they will be given hereafter. It seems, then, that the importance of the presentation of long-term strategic goals lies elsewhere. It reflects the intense inclination toward economic modernization of China's leaders. Among the Chinese people's three great tasks--(1) the building of socialist economic modernization; (2) the realization of unification of the motherland, including Taiwan; and (3) opposition to hegemonism and preservation of world peace--"the core is economic development, and this is the foundation for the solution of international and domestic problems." Regarding the earnest wish of the Chinese people, that of making a poor, backward nation into a prosperous, strong nation not subordinate to any foreign nation is "the ideal dreamed of by the Chinese people."

The Sixth Plan, Formulated by China on Its Own

The Sixth 5-Year Plan, the second important event, was adopted by the National People's Congress toward the end of last year. The Sixth Plan started in 1981, so it was approved after 2 years had already passed, but the lateness of settling on the plan in itself is not important.

That is to say, although China is known as a planned-economy nation, in the past, there is no case of a 5-Year plan being established before the beginning of the plan period. The First Plan, which started in 1953, was drawn up with the assistance of the Soviet Union; in the case of this plan also, it was adopted in 1955, when more than 2 years had passed. Nor has there been a 5-Year Plan, from the second to the fifth, that has lived up to the name. More importantly, one can say that there is epochal significance in the fact that for the first time the Chinese have designed, by themselves, the most detailed plan yet, with some 100,000 Chinese characters.

The contents of the Sixth Plan, as predicted, aim at medium-level growth. The value of total industrial and agricultural production, the value of total industrial production, and the value of total agricultural production all have as a goal a 4 percent annual growth rate. The goal for the growth of agricultural production exceeds the average growth rate for 1953-80, 3.4 percent, while that for industrial production is lower than the 8 percent average over the same period. Compared to the actual growth performance of recent years, without exception the goals are low.

However, in the actual process of execution the aim is a growth of 5 percent. In industry, a yearly growth rate of 3 percent for heavy industry and 5 percent for light industry is envisaged, but in the plan outline introduced in July last year, the growth rate for industry remained at 4 percent, while that of heavy industry was 1 percent and light industry, 7 percent. Thus, there was a sizable revision only 5 months later; the fact that the growth rate goal for heavy industry, which consumes a great deal of energy, was revised upward is a point that has aroused interest.

The fact that the industrial growth rate was held to a low figure is due to such factors as: 1) the coordination of industry is not simple; 2) a large-scale increase in energy production in the near future is impossible; and 3) transport has become a bottleneck. As a result, during this period efforts are being poured into the improvement of economic effectiveness through such means as improvement of the quality of manufactured goods, production of goods in demand (prevention of the piling up of goods), and raising of the amount of consumption of goods per unit of manufacture; the improvement of economic efficiency is a striking characteristic of the Sixth Plan.

In reference to basic investment for construction, which has a large influence on long-term economic growth, the scale of investment itself is pretty much the same as in the Fifth Plan at 230 million yuan, but the number of large- and medium-size construction projects, 890, is considerably fewer than in the Fifth Plan. The emphasis in investment is on energy industries such as electric power, coal, and petroleum and on transport industries, which create the conditions regulating the Chinese economy; energy and transport together make up 38.5 percent of total investment (energy 25.5 percent; transport, 13.0 percent).

The following are given as four vital measures for achieving the Sixth Plan: 1) strictly controlling fixed assets investment and assuming key construction in energy, transport and other areas and of the technological refurbishing of already established industries; 2) carrying out the readjustment and consolidation of enterprises through such measures as closure, halting operations, merger or changing the purpose of enterprises presently in poor condition, and working for improvement of the standard of management; 3) promoting technological advance, and 4) reforming the economic system.

After the end of 1980, when economic readjustment did not bring the desired results, coordinative measures were stressed over reform, and it appeared that reform would be suspended or fall back; but according to Zhao Ziyang's report, even though the principle that economic planning is the primary concern and regulation of markets the secondary concern is to be maintained, there is a need to speed up the progress of reform as appropriate.

The Direction of Reform Hereafter

As the direction for long-term reform hereafter, the use of economic levers for practical purposes, that is, reform in the spheres of prices, taxes and finance, is going to be developed. But the emphasis in the next 3 years will be: 1) in the state-run enterprises, one after another, the return of profits to the government will be changed to payment of taxes, in order to improve the relations between the government and enterprises; 2) making full use of the role of the central cities, the vertical (guidance of the central group of industries) and horizontal (guidance of local governments) contradictions should be resolved; 3) reform of the commercial circulation system and promotion of the production of manufactured goods and the trade in merchandise.

Since the actual performance in the 2 years 1981-82 exceeded the goals, the Sixth Plan's 4 percent goal could be achieved if a yearly growth rate of 2.9 percent in industry and 2.1 percent in agriculture were realized in the remaining 3 years, 1983-85. From the perspective of the future economic situation, achievement of the goals does not seem all that difficult.

Now the factors affecting a prolonged growth of the Chinese economy in the short- to medium-term are capital, energy and transport, and in the long term they are those presented in accompaniment of the long-term strategic goals and considered as strategic priorities: 1) agriculture, 2) energy/transport, 3) scientific technology and talent, as well as population pressures and the issue of employment. Here let me touch briefly on agriculture and energy.

In agriculture the increase in production is continuing as a result of the rise in the purchase prices for agricultural products that took effect in 1979 as one link in the economic readjustment policies and the reform of the agricultural production system such as the household production contracting system.

However, the question is: how many years more will the effect continue? There are indications that sooner or later, contradictions will become more pronounced such as low worker productivity and as low rate of commercialization, weakness of resistance to natural disasters, and the fact that the greater the population, the less the cultivable land.

3. Economic Policy Vis-a-Vis Overseas Policy and Sino-Japanese Economic Relations

Active Overseas Foreign Policy

For China, in proclaiming long-term strategic goals, and purposefully progressing with the building of its economy, foreign economic relations play an extremely important role. In reference to the ranking of foreign economic relations among the moves to build the economy, the perception in March 1982 that it is indeed through developing industry as rapidly as possible through the use of foreign capital and advanced technology that the difficulties now faced can be smoothly resolved was also confirmed at the subsequent 12th Party Congress and National People's Congress.

For example, in Hu's report at the party congress, the position was taken that "to execute policies opening up to the outside and to expand foreign economic relations and the interchange of technology based on principles of equality and reciprocity constitute our country's unshakable strategic course," and also that: 1) the advance of domestic products into international markets will be promoted and overseas trade will be greatly increased, 2) all possible usable foreign capital will be employed to further construction, 3) advanced technology which is appropriate to national circumstances, in particular advanced technology that can serve in the technological revamping of enterprises, will be actively introduced.

Also, according to the Sixth 5-Year Plan, the exchange of foreign trade and economic technology will be expanded based on the principles of equality and reciprocity and the principle of unified bargaining with the outside made possible by unified planning and unified policy; a yearly increased rate of 8.1 percent in exports and of 9.2 percent in imports is envisaged. In addition, in the area of imports the aims given are to increase the percentage of new technology and equipment (which will be a key) among imports as a whole; and to expand as appropriate the scale of the use of foreign capital through the introduction of direct investment.

In reference to the introduction of such loans, regarding loans made other than on a government basis or the long-term low-interest loans of the World Bank and other international organizations, in the past China was extremely circumspect, due to its lack of confidence in its ability for repayment, but in October last year, the statement was made that even the introduction of loans with interest up to 10 percent could be considered.

Thus, China is seeking the capital, technology and equipment necessary for building its economy from foreign countries. And our nation can be counted as one of the countries that is likely to be able to respond to these requests from China. February last year marked the 10th anniversary of the normalization of relations between Japan and China. The development of Sino-Japanese economic relations over these 10 years has been remarkable; already relations are deepening in a wide variety of fields such as trade, cooperation in regard to capital, cooperation in the development of resources, and the refurbishing and merger of existing enterprises. With this as the foundation, along with the development of China's economic building aimed at the year 2000, Japanese-Chinese economic relations should experience even more diverse development.

Here, I would like to look at the present situation and the issues in the economic relations between Japan and China.

Table 3 (1). Estimates of Japan-China Trade (Unit: \$1 million)

| | Value | Imports and Exports vs last year vs world- wide figures | | | Exports vs last year vs world- wide figures | |
|------|--------|---|-----|-------|---|-----|
| 1970 | 832 | 31.5 | 2.2 | 569 | 45.5 | 2.9 |
| 1972 | 1,100 | 22.1 | 2.1 | 609 | 5.4 | 2.1 |
| 1975 | 3,790 | 15.2 | 3.3 | 2,259 | 13.9 | 4.1 |
| 1978 | 5,079 | 45.7 | 2.9 | 3,049 | 57.2 | 3.1 |
| 1980 | 9,401 | 41.3 | 3.5 | 5,078 | 37.3 | 3.9 |
| 1981 | 10,387 | 10.5 | 3.5 | 5,095 | 0.3 | 3.4 |
| 1982 | 8,863 | -14.7 | 3.3 | 3,511 | -31.1 | 2.5 |

Table 3 (2) Estimates of Japan-China Trade (Continued) (Unit: \$1 million)

| | | Imports vs last year vs world- wide figures | | Balance |
|--------|-------|---|-----|---------|
| (1970) | 254 | 8.1 | 1.3 | 315 |
| (1972) | 491 | 52.0 | 2.1 | 118 |
| (1975) | 1,531 | 17.3 | 2.6 | 728 |
| (1978) | 2,030 | 31.2 | 2.5 | 1,019 |
| (1980) | 4,323 | 46.3 | 3.1 | 755 |
| (1981) | 5,292 | 27.4 | 3.7 | -197 |
| (1982) | 5,352 | 1.1 | 4.1 | -1,843 |

Mutually Important to Each Other as a Trading Partner

First of all, there is trade; in Japan's trade with China in 1982, exports came to \$3,511 million (a 31.1 percent decrease compared with the year before) and imports came to \$5,352 million (a 1.1 percent increase), a unfavorable balance for Japan of \$1,841 million.

In Japan's trade (valuing both exports and imports), China accounts for 3.3 percent (exports, 2.5 percent; imports 4.1 percent), placing it in sixth place as a trading partner (fifth in 1981), following the United States, Saudi Arabia, Indonesia, Australia, and the United Arab Emirates.

In our nation's trade structure, nations providing resources and fuel are in the highest positions. In the case of China, although the relative availability of resources such as petroleum is high, China is not entirely a resource- and fuel-providing type of nation; nevertheless, without the "weight" of goods supply, its position would be somewhere near the middle among Japan's trading partners. Also, even recognizing that the relative weight of trade with China has been gaining for the last few years, viewed in the light of the prewar average in 1934-36 of 18 percent of exports and 11 percent of imports, it is still not all that high.

On the other hand, the position our country occupies in China's trade has been that of the largest trading partner nation continuously since 1965. In 1981 it accounted for one-fourth of the total trade, with 25.4 percent (exports, 22.6 percent; imports, 28.6 percent), making it first among the various trading partners, followed by Hong Kong (15.8 percent), the United States (14.3 percent), West Germany (5.0 percent), and Canada (3.1 percent). In China's trade, the weight of trade with Japan exceeds the weight of trade with the United States in Japan's trade (in 1981, 21.6 percent of total trade; 25.4 percent of exports, 17.7 percent of imports).

Even looking at the composition of exported and imported goods for each country, each country fulfills an important role for the other. In 1981, in the composition of Japanese goods exported to China, machine equipment takes up almost half, 48 percent; followed by steel and all other metals, 25 percent; synthetic and other textile goods, 12 percent; and chemical products, 10 percent. Our nation is providing in large quantity the plants, technology and materials necessary for China's industrialization. The percentage of machine equipment imported from Japan out of all of China's machine equipment imports was 38 percent in 1980, and as much as 44 percent in 1981. Note, though, that the reason the percentage of machine equipment imported from Japan rose so much was that the great quantities agreed upon in 1978 and 1979 continued being shipped until 1981, and after 1982 the relative weight should go down considerably. Nevertheless, there should be no change in Japan's status as the greatest provider of machine equipment.

In 1981, the composition of merchandise, imported to China from Japan, coal and other mineral fuels accounted for 55 percent; manufactured goods, 24 percent; foodstuffs, 10 percent; fuel-related goods, 10 percent; the "weight" of mineral fuels is more than half. In 1981, the amount of Japanese petroleum

imports taken up by Chinese petroleum was 8.83 million tons, a relative weight of 45 percent, putting it in fifth place, and for coal it was 2.72 million tons, 3.5 percent, fifth place, aiding in the diversification of our nation's energy imports.

When one thinks of a sustained increase in Sino-Japanese trade on the side of exports to China, our nation has capability to provide the plants, technology and equipment necessary to China under competitive conditions, but on the other hand there is the difficulty that the Chinese capability to provide our nation with the necessary raw materials and energy resources is meager. In 1981, the composition of goods our nation imported from China as a whole was 50.6 percent for mineral fuels, 14.0 percent for raw materials and 11.1 percent for foodstuffs; these alone came to 75.7 percent of the total, and imported manufactured goods came to no more than 24.3 percent.

China is a food-exporting nation, but at the same time it is a large-scale food-importing nation, primarily of grains, and one should not expect any more than a limited rise in China's self-sufficiency in foodstuffs. The picture is the same for raw materials.

Regarding mineral fuels, for the time being demand for both petroleum and coal has eased, so there is no great desire for increased imports on the part of Japan, besides which China's ability to supply more than domestic needs is meager. As for coal, the estimated deposits in China are abundant and the outlook is hopeful in the long term, but development requires about 10 years, and up to 1985, an increase in the supply of no more than 1-1.5 million tons per day can be expected. In the case of petroleum, Japan's yearly import volume for 1983-85 has been agreed upon at 8-8.6 million tons and should be under the 1981 level.

Looking at the options this way, what can be expected to increase over the short- to medium-term is manufactured imports centered around textiles and miscellaneous goods. What will increase rapidly in the next 4 or 5 years is textile goods such as clothes and sundry items such as footwear; these are goods which make use of China's most advantageous conditions--its abundant labor force.

Development of Resources and Capital Assistance

In the long term, good things are expected from resources such as China's coal, petroleum and nonferrous metals. Thus, capital related to development of petroleum and coal resources to be furnished by Japan's Export-Import Banks (¥420 billion or about \$2 billion) was agreed upon in 1979, and a yen loan (the framework of the first yen loan being ¥300 billion over 5 years, or about \$1.5 billion) connected with supplying Japan with coal has been provided. Seven coal mines with a production total reaching 21 million tons are being developed, and some of the development capital will be used for the development of oil fields such as those of northern China and Shengli.

Yen loans are being used in three cases of railroad construction and two cases of port construction. The first phase of yen loans to the government will end in 1983, so China is already asking for a second phase to start in

1984 of some \$6 billion (¥1,380 billion) worth of yen loans for 12 projects, giving priority to the maintenance of transport routes for coal exports, such as railroads, harbors and hydroelectric power.

In reference to the development of nonferrous metals, there is again a strong element of anticipation of Japanese assistance; during Prime Minister Suzuki's visit to China in September last year, Premier Hu Yaobang proposed the large-scale joint development of nonferrous metal resources. Also, joint oil exploration with foreign countries has moved from the Phai, which was previously the only area, into the South China Sea and the Yellow Sea. In August last year, international bids were submitted for joint development; 33 foreign firms submitted bids, and from Japan the National Oil Corporation and Idemitsu Gas Development are participating. The general view is that the results of the bidding will be made known this spring. There is and will continue to be a vast demand for capital for the development of resources such as coal and oil and for the building of railroads and harbors relating to transport; a great deal is expected of the various countries, beginning with our own nation. It is said that for the development of oil and coal alone, \$20-40 billion is necessary, and much of that is expected to come from foreign assistance.

Restructuring and Merger of Existing Enterprises

At present, when it has become difficult to achieve economic growth through the construction of a large number of new factories as in the past, technological improvement and renewal of equipment, centered on energy conservation among the more than 380,000 established industries has become an important issue. In the Sixth Plan, 36 percent of fixed asset investment capital is allotted for fixed capital investment; the estimate is for a yearly average of 26 billion yuan. In the case of the revamping of established industries as well, the hope is for foreign assistance; in particular, in the case of technological improvements in medium-size and small enterprises, the planning is for the introduction of 3,000 items in the way of advanced technology in the 3 years 1983-85. Our nation's enterprises provided, factory diagnoses at 16 factories in 1981 and 33 factories in 1982; the expectation is that year by year the number of such factories will grow. The Chinese are adopting a positive attitude toward joint undertakings within China as well. By the end of 1982, the number of permitted joint companies reportedly reached 48, of which 4 companies were jointly held by Japan. Compared with Hong Kong and the United States, the number of joint ventures with our country's firms is small. The reason for this is that conditions for joint ventures are strict and lack appeal. Unless there is a positive response on the part of China for easing up on conditions regarding the percentage of exports, the expansion of preferential treatment measures and joint ventures with the objective of import substitution, the full-fledged development of joint ventures in the manufacturing area is likely to lag. It should be noted, however, that at present, as one measure for preparing the "environment", concluding negotiations between the two governments on an investment guarantee agreement and a tax treaty are proceeding.

Developing Economic Relations Between Japan and China

As we have seen, as long as China plans active building of its economy and industrialization, the possibilities for growth in the economic relations between Japan and China are great. In this case, what will be a limitation in the matter of trade will be China's ability for payment in foreign currency. Many times in the past, restrictions on imports have been forced on China due to the "wall" regarding foreign currency supply, and as a result limits have been put upon economic growth. China's strong demand for the introduction of low-interest loans and direct investment in joint ventures etc., as well as tourism, the export of labor, and so forth, can be seen as an expression of the effort to ease the strictures on foreign currency supply. The greatest step to take to obtain foreign currency is exports, but it is predicted that growth in world trade in the eighties will be low, and also the general view is that a great deal of effort will be required to increase exports steadily while protectionist tendencies are growing in various countries.

In conclusion, let us touch on the change in foreign policy and on foreign economic exchange since the latter half of last year. At the time of the 12th Party Congress, China reoriented its previous policy of looking to the West, and began aiming at strengthening relations with the Third World and normalizing Sino-Soviet relations. This kind of change in China's foreign policy is a continuation of the line of the Third Plenum at the end of 1978 which affirms that in proceeding with the building of the economy, over the long term a peaceful environment is necessary, and this encompasses a normalization of relations with the Soviet Union. Therefore, the normalization of Soviet-Chinese state relations is not likely to have any great effect on the economic exchange with the advanced Western industrial countries, starting with our nation.

Of course, if Sino-Soviet state relations were normalized, the Soviet weight in China's present trade as a whole of only about 1 percent (0.6 percent in 1981, 23d) and other economic exchanges would probably increase slightly, but it would not be possible for the Soviet Union to regain a "weight" of 48 percent (1959) such as it held at the high-water mark of the late fifties.

This is because the economic relations between China and the Western industrialized nations have deepened too much over the past 20 years, and as long as China wants to proceed with the building of its economy predicated on the improvement of economic efficiency, it does not appear that China would desire changes that would have a strong impact on realization of this. It is interesting in this connection that China is striving for the adoption of international standards, or in their absence, advanced foreign standards, for its manufactured goods. This is aimed at increasing exports and at improving quality and economic efficiency; but it can also be viewed as a reflection that economic exchange with the Western advanced nations is a long-term policy.

ECONOMIC

SURVIVAL OF TRADING COMPANIES QUESTIONED

Tokyo SENTAKU in Japanese Jul 83 p 88-91

[Text] "How to Reverse the Trend for 'Disenchantment with Trading Firms'; The Increasing Influence of Trading Firms Backfires; Increases in Borrowing Cutbacks; Entering the Severe Era of Power Plays; Assuming the Role of Conduits--Using their Intelligence Network"--These were the five titles of a series of articles published beginning on 14 February 1977, and given the overall title of "General Trading Firms Explore the Future". The year 1977 was the period when the first oil crisis had finally been put to rest and Japan was entering the era of a slowed down economy. The basic steel industry was involved in a life or death struggle of reduced volume economy by maintaining profits even with a 30 percent reduction in output. The auto industry was just emerging from a domestic recession caused by the oil crisis and preparing for an export offensive. The electrical industries were back on their feet due to the performance of the home video tape recorder.

Six years have since passed. The steel industry has stabilized its ordinary steel production to the 100-million-ton level with a target of 60 percent of production capacity operating. The auto industry, because of its concentrated drive for exports, has come face to face with export restrictions and is now finally entering the era of stable growth. The electrical equipment industry, as expected, has seen the home video market turn into a major sector with VTRs taking over the preeminent seat in place of TVs. Additionally, during these 6 years, electronics technology has seen a phenomenal growth and is now at the forefront of a new industrial revolution.

In the 10 years since the first oil shock, our major industries claim they have pursued a policy of total adherence to reduced-pace economy. If there is only one exception to this, it would be the exports industry, specifically the general trading firms. As long as Japan is a trading nation the role of its trading houses will not change.

However, the environment surrounding the trading firms grows more severe with each passing year and they are now touted as being in their "winter years." Why is it the winter years for the trading companies? A look at their sales statistics will give you an immediate answer. The sales in the past quarter of the nine major trading house is 80 trillion yen but the operating profits, which reveal the final profits for the period, are a mere 230 billion yen.

The profits of the trading houses "unsurpassed" in the world even when totaled are equal to only 60 percent of the profits of Toyota Automobiles. If viewed merely from the point of view of profits, trading houses are certainly a structurally depressed industry.

No Efforts Were Directed To Counter Recession

The misfortune is that the trading houses employees, often referred to as the elite in the business world, failed to recognize that their own trading firms were among the structurally depressed businesses. The bad part is that many of the managers had had glimpses of this coming about but had not taken any concrete steps to counter it--just a wringing of their hands. As proof of this are the headlines of the news articles of 6 years ago which took up this subject, which at this time seems to have been directly on target. It can be said that the general trading companies took no measures to extricate themselves from this structural recession in the entire period of the past 6 years.

The downward trend in gross profits continued but, on the other hand, expenses have increased annually and bad credits have continued to increase as well. In a sense, all of the trading firms which have established a U.S. presence would be better off not conducting any business but just manipulating money. If things proceed as they are at present, the trading firms will soon be unable to operate. All of the trading firms have now begun to realize the seriousness of their situation. The first step toward improving management is to cut personnel expenses which account for more than 60 percent of sales management expenses. Trading firm employees are reknown for their high salaries and are the envy of all industry. If interpreted in the good sense, it is because good people are the assets of a trading company. However, all trading companies have been paying much higher salaries than the actual state of management would justify.

Here is one specific fact. It is based on 100 as the base figure for 1973, the year before the first oil crisis. In 1981, the gross income was 143 and personnel expenses were 188 while management profits were 104. The index for 848 firms listed on the first section of the Tokyo Stock Exchange using the same base was 163. In other words, the trading companies have allocated the entire increase in gross profits over the past 9 years to personnel expenses. As a result, management profits have not grown and internal reserves have not been built up.

According to a private business survey which studied "Industries most popular with students" up to last year, for 3 consecutive years, Mitsubishi Shoji had ranked number one. Although Tokyo Marine and Fire Insurance took over the lead, trading firms still rank high among students. Among the reasons for this are the high salaries paid. For the past several years, the trading houses have covered over the fact that theirs was a structurally depressed industry by paying these high salaries.

But, now in the midst of the "winter season," they can no longer continue this subterfuge. Looking at the semiannual and annual results of this year's spring struggle for wage increases for the nine major trading firms, all nine showed a 3.3 percent drop against the same period of last year. C. Itoh and Kanematsu registered a minus. Mitsubishi Shoji, the top-ranking trading house had a zero increase in base pay and annual bonuses were the same as for last year. Mitsui Bussan, on an annual basis, compared to last year, rose 5.9 percent, but, because they had had a 2.2 percent drop last year due to deficits, if the 2 years are averaged out the increase rate comes to only 1.9 percent annually.

The reason the lower ranking trading firms crossed the line to cut personnel expenses was due to the fact that they had reached their limit in capacity to pay. However, for Mitsubishi Shoji, the top firm, to have kept their pay raises to zero appears to have been in deference to their customers. Mitsubishi Shoji's last March accounting period results shows gross income rate at 1.34 percent, the lowest of the top nine major firms. This reflects the fact that they concentrated on materials but the materials industry is in an even worse position than Mitsubishi. It is only natural that client complaints had been directed at them.

Present Volume of Business Can Be Handled by Half Present Personnel

Now the trading houses are claiming that, as late as it may be, they are considering ways of getting out of their structural recession. However, just a slight lowering of base salaries is insufficient. If breakup of facilities is a means of extricating manufacture from structural recession, then personnel reduction is a must for trading houses. In the case of the major firms, two-thirds of the present staff could adequately handle present business volumes. Some executives who take a even harsher view say that only one-half of the present personnel would be sufficient.

The reason such arguments as "one-half of the personnel would be sufficient: come to the forefront is because the content of the human resources is probably now shallow. One personnel official of a trading firm says, "A trading firm's treasure is definitely its personnel, but in actuality 80 percent of them are just bodies. There are about 19 percent of good people and 1 percent who can actually do the work of the firm. The bad thing it is that the mass of bodies are the ones who have the 'big business' complex."

In all cases, as the organizational structure of the firm grows, they become bureaucratic in nature. Naturally, corruption is born. Leading Mitsubishi Shoji men jokingly referred to the type of employees highly regarded in their firm--known for its organization orientation as opposed to Mitsui which is personnel oriented--as follows: "Highly regarded managers are managers who never leave their telephones so that they can always respond to calls from their superiors"; "Good section chiefs are those who call far and wide for documentary support in order to please the managers"; "Good ordinary staffers are those who steadily grind out reports in order to make their section chiefs look good." In a slogan drive within the firm there was one which said "The wild and unruly are devoured by intellect."

But, even so, as a fact of life, even if new employee hirings are reduced in order to reduce personnel, they cannot resort to layoffs as the United States can. The question is what can be done to continue growth without reducing personnel and at the same time continue to show profits? This is the big problem that has been thrust at the trading firms for the moment.

There is only one reply. It is to force the industrial structure to respond to the contents of their operations. The reason the trading firms are described as being in their "winter years" is that after the first oil shock there was a slippage between the industrial structure of Japanese economy and the composition of products handled.

The general trading companies grew in the postwar years by handling the transactions involving raw materials for the materials industry (steel, chemicals, petroleum, aluminum, pulp). However, this materials industry began showing signs of slipping following the oil shock. Next autos, then the electrical industry, computers, timepieces, cameras and plants, in a sense the machinery industry, came to the fore as the mainstay of the Japanese economy. Then, machinery came to hold a two-thirds share of the entire export market. Within this milieu, the only area in which the general trading firms could be said to be strong is in the field of plant exports which required a knowledge of international financing.

The new feedstocks replacing the raw materials industry is without question the machinery industry as far as the trading firms are concerned. Of the 34 operating headquarters of Mitsubishi Shoji, one-third, or a total of 8 [sic] are machinery related. Even so, it is difficult to woo back the manufacturers to the general trading houses once they have cut their ties. Even by increasing machinery related operations activities, the general trading firms continue to raise 60 percent of their revenues from the raw materials related businesses of steels, energy and chemicals. The new area in which the trading houses have set their sights are biotechnology, electronics, new media and new raw materials--all new industries based on advanced state technologies.

In recent years, all trading firms have established in-house technical departments, technical headquarters and are grappling with advanced-state technologies but they are faced with many problems. The fact is that there is a dearth of competent personnel in the trading firms. All of the technical departments in the trading firms are staffed by nothing more than employees who have an in-house reputation of "being strong in technical matters." They are, in essence, a group of amateurs. What they are doing is nothing more than brokering for foreign technologies.

New industries based on advanced technologies may be only about 2 percent of GNP but they are expected to rise to about 5 percent in the future. It can be said that the trading houses are looking to the future in this regard but on another plane even though it is bright in its future outlook, it can never exceed one-fourth of the GNP. And, this would not come about until the 21st century. Looked at with sober eyes, the risk is too great for trading firms to place all of their eggs in this basket when they are so lacking in technical know-how. It will certainly never become the key to a rebirth of the trading firms.

Only 1 percent Personnel Can Be Termed Professional

In order for general trading firms to extricate themselves from the "winter season," they must firm their positions with existing industries before they attempt to take on the new industries. To do this, they must nurture professionals in the various fields. Perhaps because the general trading firms are structured vertically along product lines it appears that there will be many experts within each of the sectors. Actually there are very few. As the personnel manager who was quoted earlier has said, only about 1 percent can be classed as professionals. The remaining 99 percent can be said to be only familiar with the details of the transactions. If this is the case, then, they may be able to subcontract for the manufacturer but can hardly be of assistance in industry strategy or in the development of new product areas.

Even the subcontractors status is verging on jeopardy. For instance, they are unable to get in on the domestic sales of steel to the largest users, the auto industry and the shipbuilders and have to be content with sorting out the delivery slips and receiving token payments. They are, of course, excluded from all negotiations involving cost hikes. In the case of iron ore and coal imports, the trading firms used to handle the import negotiations but this has now been taken over by the steelmakers. As a result, they cannot get the profits from manipulation of payments to take advantage of international currency rate fluctuations.

But, there is a way to drive a wedge into the steelmakers. That is to help the steelmakers with their overseas strategies. Entry into the U.S. market is not the exclusive domain of the household electrical appliance and auto-makers. The steelmakers have no alternative but to tear down the trigger-pricing mechanism and go into overseas production facilities if they want to continue exporting.

Nippon Kokan was the first in the steel industry to make a move. This was the purchase of the River Rouge Steel Plant of the Ford Motor Co. Mitsubishi Shoji is the company which brought the offer to Nippon Kokan. Mitsubishi Shoji was slated to participate in the capital of the firm once the plant purchase had been completed. But, due to problems involving labor unions, the talks for takeover disintegrated in May of this year. The reason for the failure of the talks was because Nippon Kokan had no expertise in U.S. labor union matters so they had given Ford carte blanche to negotiate with the United Auto Workers. This occurred just at the time when American auto workers, in an effort to counter Japanese inroads, had begun to change from a confrontational position vis-a-vis management to one of cooperation. Ford claimed that American auto industry "commonsense" would not allow them to demand a wage decrease as demanded by Nippon Kokan since such a demand would rupture the cooperative atmosphere between management and the UAW. Nippon Kokan was not aware of this "commonsense". Mitsubishi Shoji should have known, but unfortunately did not have an automobile professional expert enough on matters concerning the U.S. auto industry. If Mitsubishi Shoji had had such expertise, they could have advised Nippon Kokan and through such advice

Nippon Kokan could well have negotiated directly with the UAW and the results might well have been different. If the talks had concluded successfully and a joint venture had come into being, Mitsubishi Shoji would have been in a position to garner a fairly substantial business opportunity in the United States. The fish that got away is always the largest.

Mitsubishi Shoji has shown its ignorance in one more case involving automobiles. In January of this year, a Mitsubishi Shoji vice president, Toshihiro Tomabechi, who is concurrently president of Mitsubishi Shoji, U.S. (slated to become vice chairman of Mitsubishi Auto Industries in late June) armed with an introduction from Morgan Guaranty Bank called on the General Motors chairman, Smith, to try to sell Mitsubishi-built auto engines. Sales by top officials is well and good but Mitsubishi did not know that the engine they tried to sell to General Motors was the same as the one being developed by Isuzu Motors with whom General Motors has a financial stake. The talks never materialized. If Mitsubishi had done its homework and had accurately known the details of the General Motors-Isuzu tieup and if they had known what General Motors was seeking, they probably would not have made this unnecessary and embarrassing overture.

How Do You Deny the Past and the Present?

There are ways and room for trading firms to enter into the management of durable goods manufacturers. Makers of autos and household appliance started their own sales networks in the advanced countries because the trading companies would have nothing to do with them in the past. If trade frictions had not developed, there would be no need to borrow the strength of the trading firms, however, in starting production facilities in advanced countries and in starting joint ventures with foreign firms many opportunities are provided for trading companies to play major supporting roles.

The question is whether the trading companies have the personnel who can respond to the needs of the manufacturers. The fact that C. Itoh Shoji was able to set up the General Motors--Toyota Joint venture lies in the fact that they had, inhouse, an automobile expert. Such work, while it may not relate directly to visible profits, when viewed from the long-range aspect surely brings about business opportunities eventually. It is a definite means of getting away from being mere commission agents.

There are reverse cases as well. Marubeni successfully sold Nissan Autos to the United States in the latter part of the 1960s when Japanese autos had still not been popularized. With this is a starting point, both companies held on to each other's stocks and eventually Marubeni came to handle all of Nissan's exports to the United States. Marubeni had a firm hold on the business done by Nissan, but in the past 2 years had disposed of more than one-half of its holdings of Nissan stocks. Marubeni has in effect relinquished its business opportunity with respect to Nissan products but we are led to wonder if anyone of the management staff is aware of what has happened.

The biggest fault of the trading firm man is that even though he is an amateur he deludes himself into believing he is a professional. For instance, if you get him to write about the future of the industrial sector of which he is in

charge, he will come up with a report that will put a professional commentator to shame. But its contents would be indeed bleak. Although business man that he may be, his report is on the whole a showpiece type of report based primarily on long-range outlook papers generally published by governmental agencies and business associations. It is no different from a report written by staff personnel.

A real professional in the field would use raw data and write an inductive conclusion but 99 percent of them cannot do this. They may have professional-level information about the products for which they are responsible but they are unable to relate this information to its place within the industry or to industry as a whole or even within the context of the country's economy.

In order for general trading companies to recover some of the glories of their heyday, they must begin by denying the past and the present. Clinging to their past glories, analyzing the present and viewing the future will not lead them out of their present morass. The trading firm man, only by becoming professional and making his mark in the various industries can regain his lofty status. If they cannot nurture the professionals from within their own ranks, an alternative may be to recruit from industry.

To shed themselves of their amateur status is the only way to remaining a viable force.

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